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ALEXANDER L. STEVENS

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No. 83-458

**In the Supreme Court of the United States**

OCTOBER TERM, 1983

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JOHN R. BLOCK, SECRETARY OF AGRICULTURE, AND  
UNITED STATES DEPARTMENT OF AGRICULTURE,  
PETITIONERS

*v.*

COMMUNITY NUTRITION INSTITUTE, ET AL.

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ON WRIT OF CERTIORARI TO  
THE UNITED STATES COURT OF APPEALS  
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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JOINT APPENDIX

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PETITION FOR CERTIORARI FILED  
SEPTEMBER 16, 1983  
CERTIORARI GRANTED NOVEMBER 28, 1983

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UNITED STATES COURT OF APPEALS  
FOR THE  
DISTRICT OF COLUMBIA CIRCUIT  
GENERAL DOCKET

APPEAL FROM THE DISTRICT COURT

COMMUNITY NUTRITION INSTITUTE, ET AL., APPELLANTS

v.

JOHN R. BLOCK, SECRETARY

UNITED STATES DEPARTMENT OF AGRICULTURE, ET AL.

No. 81-2191

DATE	FILINGS—PROCEEDINGS
(T)11-12-81	Copies of notice of appeal and docket entries from Clerk, District Court (n-4)
(T)11-12-81	Docketing fee was paid in the District Court on 11/06/81
(V)12-21-81	Notice from District Court stating that record on appeal cannot be transmitted at this time because it cannot be located
(E)01-06-82	Certified Original Record (1 volume) (n-4)
(V)02-16-82	15-Appellants' brief (m-16)
(V)02-16-82	7-Joint appendix (m-16)
(V)03-10-82	4-Appellees' (federal) motion to extend time to file brief to 04/05/82 (m-10)
(C)03-12-82	Clerk's order that the motion of appellees for extension of briefing time is partially granted and the time for filing appellees' brief is extended to and including 4/1/82
(V)03-23-82	4-Appellees' (federal) motion to extend time to file brief to 04/05/82 (m-23)
(V)03-24-82	Clerk's order that appellees' motion for extension of time is granted and the time for filing appellees' brief is extended to and including Monday, April 5, 1982 provided that appellees' brief is physically delivered to the Office of the Clerk by 4:00 p.m. on that date.
(C)04-05-82	15-Appellees' (Fed) brief (m-5)
(C)04-05-82	15-Appellees' (National Milk Producers Fed, et al.) brief (m-1)
(C)04-19-82	15-Appellants' reply brief (m-19)



- (B)07-15-82 Letter dated 07-12-82 from Chief Staff Counsel requesting oral argument formats by 07-29-82
- (C)08-02-82 Letter dated 7/22/82 from counsel for federal appellee concerning format for oral argument
- (C)08-02-82 Letter dated 7/15/82 from counsel for appellants concerning format for oral argument
- (C)08-11-82 Clerk's order, sua sponte, that the following times are allotted for oral argument: Appellants—20 minutes; Federal appellees—13 minutes; intervenor-appellees—7 minutes
- (B)10-04-82 ARGUED before Tamm, Wilkey and Scalia, CJ's. On motion of Mr. Bells, Mr. Berde, a member of the bar of the Supreme Court of Minnesota, was allowed to argue pro hac vice for appellees.
- (S)01-21-83 Opinion for the Court filed by Circuit Judge Wilkey.
- (S)01-21-83 Opinion concurring in part and dissenting in part filed by Circuit Judge Scalia.
- (S)01-21-83 Judgment by this Court that the judgment of the District Court is hereby affirmed in part, reversed in part, and the case is remanded to the District Court for a decision on the merits, all in accordance with the opinion of this Court filed herein this date.
- (S)01-21-83 Mandate order.
- (J)02-03-83 1-Appellants' bill of costs (m-3)
- (J)02-17-83 4-Appellees' (Federal) opposition to appellants' bill of costs (m-17)
- (J)02-22-83 11-Appellees' (National Milk Producers Fed, et al.) motion to extend time to file petition for rehearing and suggestion for rehearing en banc to 03-28-83 (m-16)
- (B)03-01-83 4-Appellants' reply to appellees' (fed) opposition to appellants' bill of costs (m-25) (OK,GF)
- (V)03-02-83 Per curiam order that the motion of intervenor-defendants-appellees for extension of time in which to file petition for rehearing and suggestion for rehearing en banc is granted and the time extended to and including 03/28/83; Tamm, Wilkey and Scalia, CJs
- (J)03-07-83 15-Appellees' (Federal) petition for rehearing and suggestion of rehearing en banc (m-7)

- (J)03-25-83 15-Appellees' (Nat'l Milk Producers Federation, et al.) petition for rehearing and suggestions in support of rehearing en banc (m-24)
- (V)03-28-83 Per curiam order that the Federal appellees' petition for rehearing, filed 03/07/83 is denied; Tamm, Wilkey and Scalia, CJs (Circuit Judge Scalia would grant the petition for rehearing)
- (V)03-28-83 Per curiam order, en banc, that the suggestion for rehearing en banc is denied; CJ Robinson, Wright, Tamm, MacKinnon, Wilkey, Wald, Mikva, Edwards, Ginsburg, Bork and Scalia, CJs (Circuit Judges MacKinnon, Bork and Scalia would grant the suggestion for rehearing en banc)
- (S)04-05-83 Copy of opinion and certified copies of judgment issued to District Court. Costs to issue at a later date.
- (S)04-07-83 Clerk's order, sua sponte, that the certified copies of judgment and an [sic] copy of the opinion in lieu of formal mandate, issued to the District Court on April 5, 1983 be, and are hereby recalled, and the Clerk of the District Court is directed to return to this Court forthwith the documents issued in lieu of formal mandate.
- (J)04-08-83 Mandate returned from Clerk, District Court per order of 04-07-83
- (V)04-19-83 Per curiam order that the petition for rehearing of intervenors-defendants-appellees, filed 03-25-83, is denied; Tamm, Wilkey and Scalia, CJs (Circuit Judge Scalia would grant the petition for rehearing)
- (V)04-19-83 Per curiam order, en banc, that intervenors-defendants-appellees' suggestion for rehearing en banc is denied; CJ Robinson, Wright, Tamm, MacKinnon, Wilkey, Wald, Mikva, Edwards, Ginsburg, Bork and Scalia, CJs (Circuit Judges MacKinnon, Bork and Scalia would grant the suggestion for rehearing en banc)
- (J)04-22-83 4-Appellees' (Federal) motion to stay issuance of mandate (m-22)
- (V)04-26-83 Per curiam order that costs in the total amount of \$500.15 are awarded in favor of appellants (Deborah Harrell, Ralph Desmarais & Zy Weinberg) and taxed against appellees (John R. Block, Sec-

- retary U.S. Dept. of Agriculture, National Milk Producers Federation, Associated Milk Producers, Inc. and Central Milk Producers Cooperative), jointly and severally. The Clerk is directed to transmit a certified copy of this order to the District Court as promptly as the business of his office permits; Tamm, Wilkey and Scalia, CJs
- (V)04-26-83 Certified copy of above order sent to the District Court
- (V)05-02-83 Per curiam order that appellees' motion to stay issuance of mandate is granted and the Clerk is directed not to issue the mandate herein for a period of thirty (30) days from the date of this order; Tamm, Wilkey and Scalia, CJs
- (J)05-20-83 4-Appellees' (Federal) motion to stay issuance of mandate (m-20)
- (V)05-27-83 Per curiam order that appellees' (federal) motion to stay issuance of mandate is denied. The mandate shall issue on 06/02/83, in accordance with this Court's previous order; Tamm, Wilkey and Scalia, CJs
- (S)06-02-83 Copy of opinion and certified copies of judgment reissued to District Court.
- (J)08-04-83 Copy of letter from Clerk, Supreme Court extending time to file petition for writ of certiorari to 09-16-83 in SC No. A-3
- (J)08-04-83 Copy of letter from Clerk, Supreme Court extending time to file petition for writ of certiorari to 09-16-83 in SC No. A-2
- (J)11-16-83 Notice from Clerk, Supreme Court that petition for writ of certiorari was filed 09-16-83 in SC No. 83-458
- (J)11-29-83 Letter dated 11-28-83 from Clerk, Supreme Court asking that record be certified and transmitted to Supreme Court
- (J)11-30-83 Copy of order from Clerk, Supreme Court granting petition for writ of certiorari in SC No. 83-458 on 11-28-83
- (J)11-29-83 Receipt dated 11-30-83 from Clerk, District Court for Certified Original Record (remaining papers)
- (J)12-02-83 Letter dated 12-05-83 from Chief Deputy Clerk to Supreme Court submitting certified record
- (J)12-02-83 Receipt from Clerk, Supreme Court dated 12-05-83 for certified record

(V)12-12-83 Per curiam order that the Clerk of the District Court is requested to return to this Court the certified copy of the judgment and the opinion transmitted on June 2, 1983 in lieu of formal mandate; Tamm, Wilkey and Scalia, CJs

COMMUNITY NUTRITION INSTITUTE,  
DEBORAH HARRELL, RALPH DESMARAIS, ZY WEINBERG,  
JOSEPH OBERWEIS, PLAINTIFFS

v.

BOB BERGLAND, SECRETARY, UNITED STATES  
DEPARTMENT OF AGRICULTURE, UNITED STATES  
DEPARTMENT OF AGRICULTURE, NATIONAL MILK  
PRODUCERS FEDERATION, ASSOCIATED MILK PRODUCERS,  
INC., CENTRAL MILK PRODUCERS COOPERATIVE,  
INTERVENOR-DEFTS.

DATE	NR.	PROCEEDINGS
1980		
Dec 2	1	COMPLAINT; Exh. A-E; appearance.
Dec 2		SUMMONS (4) and copies (4) of complaint issued. U.S. Atty. serv. 12-3-80. Atty. Gen. serv. 12-8. Defts. serv. 12-9-80.
1981		
Jan 8	2	MOTION by The National Milk Producers Federation, Associated Milk Producers, Inc. and Central Milk Producers Cooperative to intervene as party defts.; P&A's; notice; exhibit. \$5.00 paid and credited to U.S. (Appearance of James R. Murphy and Charles W. Bills, 1128 16th St., N.W., Wash., D.C. 20036, 393-8668)
Jan 12	3	CORRECTION to applicant-intervenor's points and authorities filed on 1-8-81.
Jan 16	4	RESPONSE by defts. to proposed intervention.
Jan 16	5	APPEARANCE of Dennis G. Linder and Theodore C. Hart as counsel for defts. CD/N
Jan 22	6	OPPOSITION by pltf's. to motion to intervene of National Milk Producers Federation, Associated Milk Products, Inc., and Central Milk Producers Cooperative; attachment 1.
Feb 2	7	ANSWER of defts. to the complaint.
Feb 2		CALEDARED. CD/N.
Feb 5	8	REPLY of applicant-intervenors to pltf's. opposition to proposed intervention; exhibits 1, 2, and 3.
Feb 6	9	RESPONSE by pltf's. to reply of applicant-intervenors to pltf's. opposition to proposed intervention.

- Feb 19 10 MOTION by pltfs. for an order directing defts. to certify and file the administrative record; memorandum.
- Feb 19 11 MEMORANDUM. (N) Gasch, J.
- Feb 19 12 ORDER granting motion of proposed intervenors to intervene and directing National Milk Producers Federation, Central Milk Producers Cooperative, and Associated Milk Producers, Inc. may intervene as party defts in this action. (N) Gasch, J.
- Feb 19 13 ANSWER by intervenor-defts to complaint.
- Mar 3 14 STATEMENT of P&A's by intervenor-defts. in opposition to pltfs. motion for an order directing defts. to certify and file the administrative record.
- Mar 5 15 OPPOSITION by federal defts. to pltfs. motion to certify and file administrative record; affidavit of Audrey W. Gearhart.
- Mar 13 16 REPLY by pltfs. to defts. opposition to pltfs. motion to certify file administrative record.
- Mar 20 17 MOTION by Federal Defts. to dismiss or, in the alternative, for summary judgment; statement; P&A's; cases and authorities; affidavit of Herbert L. Forest; Attachment A.
- Mar 20 CALENDAR CALL. Federal defts. to file motion to dismiss promptly; Pltfs allowed 30 days thereafter to file their reply; intervenor defts. allowed 15 days after federal defts. motion to dismiss filed to submit additional memoranda; pltfs. to respond 15 days thereafter to intervenor's memoranda, and federal defts. to respond promptly to pltfs. reply. (Rep: R. Griffey) Gasch, J.
- Apr 13 18 MOTION by intervenor-defts. National Milk Producers Federation, et al. to dismiss or, in the alternative, for summary judgment; statement of material facts. (FIAT) Gasch, J.
- Apr 29 19 STIPULATION approved by the Court allowing pltfs. until 5-1-81 to file their memorandum of P&A's in opposition to respective motions to dismiss or in the alternative for summary judgment by defts. and intervenors. (N) FIAT) Gasch, J.
- May 7 20 MOTION by pltfs. to exceed page limitation; memo of P&A's.

- May 11 21 CROSS-MOTION by pltfs. for summary judgment; memo of P&A's; affidavit of Thomas B. Smith; exhibits A and B; statement of material facts. (FIAT) Gasch, J.
- May 11 22 ORDER allowing pltfs. to file memorandum of P&A's dated 5-1-81 in excess of page limitations. (N) Gasch, J.
- May 11 22a STIPULATION approved by the Court allowing defts. and intervenor-defts. until 5-22-81 to file their memorandum of P&A's in opposition to pltfs. motion for summary judgment. (N) (FIAT) Gasch, J.
- May 21 23 MOTION by defts. #1 and 2 for extension of time to 5-28-81 to file and serve oppositions.
- May 28 24 ORDER filed May 27, 1981 granting motion of deft. and Intervenor-deft. for extension of time to May 28, 1981, to file opposition to pltf's. cross-motion for summary judgment and pltfs. to reply to deft. and intervenor-deft's. opposition by June 5, 1981. (N) (signed 5/26/81) Gasch, J.
- May 28 25 OPPOSITION by Federal Defts. to Statement of Material Facts as to Which Pltffs. contend there is no genuine issue.
- May 28 26 MEMORANDUM by Federal Defts. of Points and Authorities in opposition to Pltffs' cross-motion for summary judgment; Table of Contents; Cases and Authorities.
- June 1 27 REPLY of Intervenor-Defts., National MILK Producers Federation, Associated Milk Producers, Inc., and Central Milk Producers Cooperative to Pltffs' Memorandum in opposition to defts' Motion to Dismiss or for summary judgment and in support of pltfs' cross-motion for summary judgment; Exhibit A.
- June 5 28 REPLY by pltfs. to federal defts. and intervenor-defts. opposition to pltfs. cross-motion for summary judgment; affidavits (2).
- Sept 10 MOTION of federal defts. to dismiss and motions of pltfs., defts. and intervenors for summary judgment heard and taken under advisement (Rep: R. Griffey) Gasch, J.
- Sept 30 29 MEMORANDUM filed 9-29-81. (N) Gasch, J.



Sept 30	30	ORDER filed 9-29-81 granting motion of defts. to dismiss and dismissing the complaint with prejudice. (N) Gasch, J.
Nov 6	31	NOTICE of appeal by pltfs. from order of 9-29-81. \$70.00 paid and credited to U.S. Copies mailed to Dennis G. Linder, Theodore C. Hirt, James R. Mury, Charles W. Bills and Sydney Berde.
Nov 9		COPY of notice of appeal and docket entries transmitted to USCA. USCA #81-2191.
Nov 12 1982	32	RECORD AND ISSUES on appeal by pltf.
Jan 4		RECORD on appeal delivered to USCA. Receipt ackn.



UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-3077

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COMMUNITY NUTRITION INSTITUTE

1146 19th Street, N.W.  
Washington, D.C. 20036;

DEBORAH HARRELL  
4408 Teal Way  
Sarasota, Florida 33580;

RALPH DESMARAIS  
2318 Louisiana Street  
Little Rock, Arkansas 72206;

ZY WEINBERG  
3301 B Cherry Lane  
Austin, Texas 78703;

JOSEPH OBERWEIS  
609 Gates Avenue  
Aurora, Illinois 60505;

PLAINTIFFS,

v.

BOB BERGLAND, SECRETARY

UNITED STATES DEPARTMENT OF AGRICULTURE  
14th & Independence Avenue, S.W.  
Washington, D.C. 20250;

UNITED STATES DEPARTMENT OF AGRICULTURE  
14th & Independence Avenue, S.W.  
Washington, D.C. 20250;

DEFENDANTS.

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COMPLAINT FOR DECLARATORY ACTION  
AND INJUNCTIVE RELIEF

1. This action is brought by a nonprofit charitable organization, milk consumers, and a milk handler to review, declare invalid and enjoin enforcement of provisions of the Federal Milk Market Orders ("Orders"), 7 C.F.R. § 1000 *et*

*seq.*, which require down allocation of reconstituted milk products, and which require manufacturers of reconstituted milk products to make compensatory payments on such products to regional fresh milk producers. Such Orders, issued under the Agricultural Marketing Agreement Act ("AMAA"), 7 U.S.C. § 601 *et seq.*, create illegal economic barriers to the marketing by handlers of reconstituted milk products and their ingredients and deprive consumers of a nutritious economically priced substitute for fluid drinking milk.

2. More specifically, plaintiffs contend that the provisions of the Orders requiring down allocation and compensatory payments for reconstituted milk products should be vacated and held invalid because:

(a) they are arbitrary, capricious, unsupported by substantial evidence, and they are unnecessary to effectuate the declared purposes of the AMAA;

(b) they are in excess of the Secretary's statutory authority under the AMAA in that they create an economic barrier to the marketing of reconstituted milk products and their ingredients in contravention of the provisions of section 8c of the AMAA, 7 U.S.C. § 608c; they regulate the price of products manufactured from milk products; they result in nonuniform prices among milk handlers based on use; and they are in direct contravention of the declared policies of the AMAA.

3. This action also seeks a judgment that the Secretary's inaction with respect to plaintiffs' petition to repeal provisions of the Orders applicable to reconstituted milk products and their ingredients constitutes an arbitrary and capricious denial in violation of 7 U.S.C. §§ 608c(3), 608c(15), and 608c(16), and 5 U.S.C. § 553.

### JURISDICTION

4. This Court has jurisdiction over this action pursuant to 7 U.S.C. §§ 602 and 608c, 28 U.S.C. §§ 1331, 1337, and 1361, and 5 U.S.C. § 701 *et seq.*

### PARTIES

5. Plaintiff Community Nutrition Institute is a nonprofit charitable organization specializing in food and nutrition is-

sues. It is primarily concerned with the development, adoption and implementation of a national food policy which serves the health and economic needs of consumers, particularly low-income consumers. CNI has an institutional interest in seeing that consumers have nutritious dairy products and substitutes available at the lowest possible price. CNI also educates and informs the public about issues regarding food and nutrition.

6. Plaintiff Joseph Oberweis is a handler as that term is defined in the AMAA, 7 U.S.C. § 608c(1), of milk and milk products as that term is defined in the AMAA, 7 U.S.C. § 608c(1). The current regulations relating to reconstituted milk products and their ingredients have created economic barriers preventing Mr. Oberweis from manufacturing and marketing reconstituted milk products as well as milk powder for manufacturing reconstituted milk products. If the regulations were removed, Mr. Oberweis would manufacture and market reconstituted milk products and milk powder for use in manufacturing such products.

7. Plaintiffs Harrell, Desmarais and Weinberg are consumers of fluid dairy products. Due to inflation, they have become extremely cost-conscious and routinely seek to decrease food expenditures without sacrificing taste or the nutritional value of their diet. The existing regulations have denied them the opportunity to purchase a lower priced reconstituted milk product in lieu of raw fluid milk. If such lower priced milk were available they would purchase it.

8. Defendant Bob Bergland is the Secretary of Agriculture ("the Secretary") in whom is vested the authority to implement and enforce the AMAA.

9. Defendant U.S. Department of Agriculture ("USDA") is a department of the Federal Government created by 7 U.S.C. § 2201 and administered under the supervision and direction of the Secretary of Agriculture and is the department of the Federal Government responsible for administering the AMAA.

## STATUTORY AND REGULATORY FRAMEWORK

10. The AMAA, enacted in 1937, grants the Secretary of Agriculture the authority to regulate, *inter alia*, the marketing of milk. The declared objectives of the AMAA are, in relevant part, (1) to establish and maintain such orderly marketing conditions as will establish parity prices for farmers and (2) to protect the interests of producers and consumers by establishing and maintaining the conditions necessary to provide an orderly flow of the supply of milk and to avoid unreasonable fluctuations in supplies and prices. 7 U.S.C. §§ 602(1) and 602(4).

11. If the Secretary has reason to believe that issuance of a market order will tend to effectuate the policy of the AMAA, the Secretary is required to give due notice of, and an opportunity for a hearing on, the proposed order. 7 U.S.C. § 608c(3).

12. After the formal hearing, the Secretary shall issue an order if the Secretary finds that the terms and conditions of the order will tend to effectuate the declared policy of the AMAA. 7 U.S.C. § 608c(4).

13. Any handler subject to a milk marketing order may petition the Secretary to modify any provision of an order which is not in accordance with the AMAA. The handler must be given an opportunity for a hearing upon the petition. 7 U.S.C. § 608c(15).

14. Regulations issued by the Secretary require the Secretary to respond to a petition by a handler within 30 days. 7 C.F.R. § 900.52a.

15. Whenever the Secretary finds that any provision of an order obstructs or does not tend to effectuate the declared policy of the AMAA, the Secretary is required to terminate or suspend the operation of such provision. 7 U.S.C. § 608c(16).

16. Milk Market Orders must classify milk in accordance with the form in which or the purpose for which it is used and must fix minimum uniform prices for milk to be paid by handlers based upon such classifications. 7 U.S.C. § 608c(5).

17. Milk Market Orders may not prohibit in any production area the marketing of milk produced in any other production area in the United States. With respect to milk products, marketing agreements or orders may not prohibit or in any manner limit the marketing of milk products produced in any production area in the U.S. 7 U.S.C. § 608c(5)(G).

18. Under the authority of the AMAA, Milk Market Orders have been adopted in 47 regions of the United States. These orders are designed to insure that dairy farmers ("producers") within the geographic region receive a uniform price for their Grade A milk, regardless of whether the milk is ultimately sold to consumers as fresh fluid milk or whether it is used for manufacturing purposes.

19. Each order includes provisions for a classified price plan under which handlers pay minimum prices for producer milk based on the way the raw milk is used. Milk purchased to be resold to consumers for drinking is classified as Class I, the highest-priced class. Milk used to produce milk products such as milk powder, evaporated milk, cream, cottage cheese, yogurt, and ice cream are assigned to Class II, and a lower price is paid by the handler for this milk than for Class I milk. (Some Federal order areas divide milk used to manufacture milk products into two groups, Class II and Class III. This Complaint refers to them all as Class II.)

20. Producers within a given order area receive a uniform or "blend" price, based upon how much milk produced in the order area is sold for Class I or Class II purposes. This blend price is computed from monthly reports filed by handlers within the order area showing how much milk is used for Class I and Class II purposes. Because Class I uses demand a higher price on the market, the greater the amount assigned to Class I use, the higher the "blend" price will be.

21. Reconstituted milk products are regulated under the "other source" milk provisions of the various Milk Market Orders. Originally "other source" milk provisions were used to regulate fresh fluid milk brought into an order area from another area. However, in 1964 the "other source"

milk provisions were expanded to cover the reconstitution of milk powder by milk handlers. Under the Milk Market Orders, a reconstituted milk product, regardless of its ultimate use by the handler, is allocated to Class II. This is referred to as "down allocation". In this manner, a corresponding amount of regional producers' fresh milk purchased for manufacturing purposes is treated as if it were sold in fresh fluid form to consumers. Handlers are thus required to pay Class I prices for this milk even though the milk was purchased for Class II uses.

22. If a handler's Class II utilization is not great enough to offset all the reconstituted milk product manufactured by the handler, then the remainder is categorized as Class I and the handler is required to make a compensatory payment, equal to the difference between the Class I and Class II price level, multiplied by the volume of reconstituted milk product in this category. These compensatory payments are pooled by the Order Administrator and distributed pro rata to the local fresh milk producers.

#### FACTUAL ALLEGATIONS

23. Reconstituted milk products are dairy-derived substitutes for fluid milk. As used herein, the term includes two categories of products: (1) "reconstituted" milk manufactured by combining water with whole milk powder or nonfat powder (often with butterfat or oil added); and (2) "filled" milk manufactured by combining water with milk powder and adding nondairy fats such as coconut oil or soybean oil. In some areas of the United States, the cost of manufacturing reconstituted milk products may be substantially less than the cost of fresh fluid milk. Milk powder manufactured from milk produced in the upper Midwest, where the cost of production is the lowest, can be shipped to other areas and manufactured into reconstituted milk products for less than the cost of fresh milk produced in those areas.

24. In 1964 the Secretary promulgated an order subjecting reconstituted milk products to the "down allocation" provisions of the Federal Milk Market Orders and requiring handlers who manufacture reconstituted milk products to



make compensatory payments for any reconstituted milk product which could not be assigned to Class II uses. 29 *Fed. Reg.* 9002 (1964).

25. In 1967, following a hearing initiated by the United Dairymen of Arizona, the Secretary issued an order which placed "filled" milk under the same regulatory provisions applicable to reconstituted milk. 34 *Fed. Reg.* 16881 (1969).

26. The down allocation and compensatory payment requirements of the Orders create unfair and artificial barriers to the marketing of reconstituted milk products. When a compensatory payment is added to the actual costs incurred in manufacturing reconstituted milk products, a handler would have to price reconstituted milk products at a price equal to or higher than fresh drinking milk simply in order to recoup his or her costs. Such a price makes reconstituted milk products uncompetitive with fresh drinking milk.

27. The existing Orders create economic barriers to the marketing of milk powder manufactured in the most efficient milk producing areas of the country for use in manufacturing reconstituted milk products throughout the rest of the United States.

28. The economic barriers to marketing reconstituted milk created by the existing Orders deprive plaintiffs Weinberg, Harrel, and Desmarais and other consumers of access to a nutritious dairy beverage at a lower price than fresh drinking milk.

29. The existing Orders create economic barriers which prohibit plaintiff Oberweiss from manufacturing and marketing reconstituted milk products and from manufacturing and marketing milk powder to be sold for manufacturing reconstituted milk products.

30. The existing Orders result in a lack of uniformity of prices for milk handlers. Handlers who either manufacture or purchase dry powder which is sold to consumers to be reconstituted into a fluid milk product at home pay the Class II price for the milk from which the powder is manufactured, and they are not subjected to any compensatory payment requirement. Handlers who manufacture dry powder or purchase dry powder and then reconstitute it for the

consumer are required to make such a compensatory payment.

31. The existing Orders deprive producers and consumers of a stabilizing market influence. A reconstituted fluid product could quickly expand the fluid milk supply when seasonable changes result in a reduction of the whole fluid milk supply. Tight fluid markets and rising fluid prices could be avoided and the size of the reserve fresh whole Grade A milk needed to provide the fluid market could be reduced if such adjustments were possible.

32. In 1976 plaintiff Oberweis submitted to the Secretary a proposal to classify reconstituted milk as the lowest class milk rather than Class I milk under the Chicago Regional Milk Order. By letter dated May 25, 1976, the Secretary denied plaintiff Oberweis' proposal. In 1977, plaintiff Oberweis wrote to the President of the United States urging a change in regulations to permit the manufacture and sale of reconstituted nonfat dry milk. On March 22, 1977 the Acting Deputy Administrator of the Agricultural Stabilization and Conservation Service of the Department of Commerce responded for the President, rejecting Oberweis' petition.

33. On August 23, 1979, plaintiffs submitted a petition to the Secretary requesting that existing Milk Market Orders be amended to exclude reconstituted milk products from the definition of "other source milk" and to eliminate the requirement that handlers who manufacture reconstituted milk products make a compensatory payment to local fresh milk dairy producers. (A copy of the petition is attached hereto as Exhibit A.)

34. On November 16, 1979, the Secretary published a Prenotice of Request for Hearing on the petition and invited interested persons to submit comments on whether or not a hearing on the petition should be held and to submit additional proposals relating to the issue. January 15, 1980 was the deadline for submitting such comments and proposals. 44 *Fed. Reg.* 65989 (1979). (A copy of the November 16, 1980 pre-notice is attached hereto as Exhibit B.)

35. On January 18, 1980 the Secretary published a notice extending the comment period to February 29, 1980. 45



*Fed. Reg.* 3593 (1980). (A copy of the January 18, 1980 notice is attached hereto as Exhibit C.)

36. On July 1, 1980 plaintiffs wrote the Secretary advising him that if a decision on the petition were not forthcoming, petitioners would have no choice but to consider the petition denied and to take appropriate action. The Secretary, by letter dated August 11, 1980, responded to plaintiffs' letter, but failed to take any substantive action in response thereto. (A copy of plaintiffs' July 1, 1980 letter and the Secretary's August 11, 1980 response are attached hereto as Exhibits D-1 and D-2 respectively.)

37. On November 17, 1980, more than a year after plaintiffs' submitted their petition and more than eight months after the close of the comment period, the Secretary published an economic impact analysis evaluating the effect of plaintiffs' petitions and of an alternative proposal submitted during the comment period. 45 *Fed. Reg.* 75956 (1980). The Secretary invited comments on the impact evaluation to be submitted within 45 days, but did not make any statement with respect to when he expected to make a decision on the plaintiffs' petition. (A copy of the November 17, 1980 notice is attached hereto as Exhibit E.)

38. The Secretary's repeated delays and inaction on plaintiffs' petition has the effect of denying needed relief to plaintiffs. Elimination of the regulations could result in substantial savings to consumers. For handlers interested in marketing either a reconstituted product or milk powder for use in reconstituted products, continuation of the regulations results in substantial economic hardship and unfairness.

39. By his failure to act the Secretary has denied plaintiffs' petition.

#### **PLAINTIFFS' CLAIM FOR RELIEF**

40. The AMAA delegates to the Secretary authority to issue Milk Marketing Orders only if the Secretary finds that the issuance thereof will tend to effectuate the declared policy of the AMAA. With respect to the regulations in question, such a finding is arbitrary and capricious and was not supported by substantial evidence. The regulations

are not necessary to protect dairy farmers nor to maintain such orderly marketing conditions to establish parity prices. Moreover, the regulations are inconsistent with and thwart the AMAA's declared policy objective of protecting the interests of producers and consumers by avoiding unreasonable fluctuations in supplies and prices.

41. The Milk Market Orders create an economic barrier to the marketing of milk and milk products in violation of 7 U.S.C. § 608c(5)(G). Moreover, the Orders result in non-uniform prices among milk handlers based on use, in violation of 7 U.S.C. 608c(5).

42. The Secretary has exceeded his authority under the AMAA to set minimum prices for producer milk based on the purpose for which that raw milk is used, instead basing such minimum prices on the purpose for which a milk product is used.

43. The Secretary has ignored the AMAA's mandate under 7 U.S.C. § 608c(3) to hold a hearing on a proposed order whenever there is reason to believe the proposal will tend to further the declared policy of the AMAA. Plaintiffs' petition to the Secretary presented sufficient evidence upon which to reasonably form a belief that adopting the amendment suggested by plaintiffs will effectuate the policy of the AMAA.

44. The Secretary has ignored the AMAA's mandate under 7 U.S.C. 608c(16) to terminate or suspend the operation of any provision of a market order whenever such provision obstructs or does not effectuate the declared policy of the AMAA.

45. The Secretary has deprived plaintiff Oberweis of his statutory right to an opportunity for a hearing upon a petition requesting modification of an existing milk order.

46. The Secretary has unreasonably delayed responding to plaintiffs' petition, and such delay constitutes an unreasonable and arbitrary denial of such petition.

**WHEREFORE**, plaintiffs pray that this Court enter an Order

(a) declaring the existing Milk Market Orders insofar as they apply to reconstituted milk products and milk powder

used to make reconstituted milk products to be void and invalid and of no force or effect;

(b) enjoining defendants and all those in active concert and participation with them from implementing or in any way enforcing the regulations;

(c) requiring the Secretary to commence expeditious consideration of and grant plaintiffs' petition dated August 23, 1979;

(d) awarding the plaintiffs their costs and reasonable attorneys' fees;

(e) awarding plaintiffs such other and further relief as this Court may deem just and proper.

Respectfully submitted,

/s/

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*Attorneys for plaintiffs*

Dated:

BEFORE THE  
UNITED STATES DEPARTMENT OF AGRICULTURE  
WASHINGTON, D.C.

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CHANGES IN THE REGULATORY TREATMENT OF  
RECONSTITUTED MILK UNDER ALL FEDERAL  
MILK ORDERS

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COMMENTS OF THE ANTITRUST DIVISION,  
U.S. DEPARTMENT OF JUSTICE

SANFORD M. LITVACK  
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Attorney General*

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I. INTRODUCTION

On November 13, 1979, the Department of Agriculture invited interested parties to comment on whether a hearing should be held to consider a petition by the Community Nutrition Institute and three individual consumers (hereinafter collectively referred to as "CNI") that the Secretary of Agriculture amend the Federal milk marketing orders as they apply to reconstituted milk. 44 F.R. 65989, November 16, 1979: "Pre-notice of request for hearing and invitation to submit additional proposals or comments."

The CNI petition requested that the orders be amended to (1) remove reconstituted products from the definition of

"other source milk" for the purpose of eliminating the "down-allocation" of milk ingredients used in such products and (2) eliminate the requirement that processors of reconstituted milk products make a "compensatory payment" on such products assigned to Class I. The practical effect of the amendments proposed by CNI would be to eliminate current restrictive provisions that increase the cost of reconstituted milk.

The comment is filed in response to the Department of Agriculture's invitation. The Antitrust Division recommends that public hearings be held to consider changes in the regulatory treatment of reconstituted milk under the Federal milk marketing orders.

## II. STATUTORY AUTHORITY

The Agricultural Marketing Agreement Act of 1937, as amended [7 U.S.C. 601 et seq.] provides the basic authority for the Federal milk marketing orders issued by the Secretary of Agriculture. 7 U.S.C. 602 declares it to be the policy of Congress:

(1) Through the exercise of the powers conferred upon the Secretary of Agriculture under this chapter, to establish and maintain such orderly marketing conditions for agricultural commodities in interstate commerce as will establish, as the prices to farmers, parity prices as defined by section 1301(a)(1) of this title.\*

(2) To protect the interest of the consumer by (a) approaching the level of prices which it is declared to be the policy of Congress to establish in subsection (1)

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\*This provision must be read in conjunction with 7 U.S.C. 608c (18), which provides in pertinent part:

... Whenever the Secretary finds ... that the parity prices of such commodities are not reasonable in view of the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk and its products in the marketing area or, in the case of orders applying only to manufacturing milk, the production area to which the contemplated agreement, order, or amendment relates, he shall fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk to meet current needs and further to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs, and be in the public interest....

of this section by gradual correction of the current level at as rapid a rate as the Secretary of Agriculture deems to be in the public interest and feasible in view of the current consumptive demand in domestic and foreign markets, and (b) authorizing no action under this chapter which has for its purpose the maintenance of prices to farmers above the level which it is declared to be the policy of Congress to establish in subsection (1) of this section.

\* \* \*

(4) Through the exercise of the powers conferred upon the Secretary of Agriculture under this chapter, to establish and maintain such orderly marketing conditions for any agricultural commodity enumerated in section 608c(2) of this title, as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices.

\* \* \*

Another section of the Act provides that the Secretary does not have the authority to "prohibit or in any manner limit . . . the marketing in [any marketing] area of any milk or product thereof produced in any production area in the United States." (7 U.S.C. 608c(5)(G))

### III. THE CURRENT MILK MARKETING REGULATIONS

#### A. A Description of the Current Regulations

Federal milk marketing orders set minimum prices for milk according to use. The price for Class I (fluid use) milk is set higher than the price for Class III milk, whose uses include products such as powdered and condensed milk.\* The present orders classify reconstituted powder or condensed milk sold in fluid form as a Class I product.

Reconstituted milk is made by combining powdered non-fat dry milk or condensed milk with water. Normally, handlers who make non-fat dry milk or condensed milk pay for the milk they use at the Class III price. In areas covered by Federal milk marketing orders handlers who want to

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\*In two Class markets powdered and condensed milk are classified as Class II.



make reconstituted milk would have to purchase this dry or condensed milk at a price that exceeds the Class III price by at least the amount of drying or condensing costs. The regulations require that they also pay to the market administrator the difference between the Class I and Class III prices as a "compensatory payment" for producing reconstituted milk. The combination of the Class III price, the costs associated with drying or condensing, the compensatory payment, and the costs of reconstituting milk insure that reconstituted milk will cost a handler more than fresh whole milk. Consequently, handlers in federally regulated areas presently have no economic incentive to produce reconstituted milk.

#### **B. The Proposed Amendments Would Benefit Farmers, Handlers, and Consumers**

Current regulations deny to dairy farmers in efficient production areas access to distant marketing areas. Many local or regional markets are substantially isolated from competition from other areas because fresh milk, which is both heavy and perishable, is expensive to transport over long distances. Farmers in these markets face no competition from distant milk unless they price their milk at a level that exceeds the delivered price of the distant milk.

Condensed or powdered milk is substantially less expensive to transport than fresh milk. The process of going from fresh milk to powder is essentially one of removing water. This reduces the weight to value ratio, which lowers the transport cost per unit of milk solids. If handlers were freed from the regulations that increase the cost of reconstituting milk, they could expand the area from which they procure milk.

Dairy farmers in efficient production areas, such as the Minnesota and Wisconsin region, now produce substantial volumes of milk in excess of their local fluid needs. Presently their milk is largely limited to local fluid markets, with the surplus used for cheese, butter, and powdered milk. Opening Federal order markets to reconstituted milk would allow this surplus to compete in distant fluid milk markets, allow the economy to allocate resources to promote production in those areas which have a relative competitive advan-

tage in milk production, and result in greater overall efficiency. Milk production in efficient areas would be encouraged by higher prices and additional market outlets. Increased competition and lower prices would discourage production in high cost areas, since in these markets local producers are unable to provide sufficient milk for local fluid demand on a year-round basis at prices at or below the cost of reconstituting powdered milk from efficient areas.

Amending the regulations would promote orderly marketing on a seasonal basis. Because of seasonal variation in both the supply of and demand for fresh milk, there are presently markets where supplies of local milk are inadequate to meet consumer demand for fresh milk during some portion of the year. Handlers now meet this seasonal variation by importing fresh milk in bulk. If condensed milk or powder could be imported into these markets to produce a satisfactory reconstituted product, lower total costs for procuring milk would result.

In certain geographic markets where milk is sold at Class I minimum prices, milk cannot economically be reconstituted and sold, even absent the current restrictive regulations. However, in relatively isolated markets local producers bargain over the price of milk for Class I use with local handlers, with the result being that prices above the federal order minimum prices are charged. The cost of alternative supplies of milk places an upper limit on the premium that can be charged in these areas for Class I milk. Because of the expense of transporting distant milk, local producers often can obtain a considerable premium over the Federal order minimum price. Allowing reconstituted milk into these markets would lower these over order premiums.

Consumers also would benefit from amending the regulations. The lower costs that would result from deregulating reconstituted milk would enable consumers to enjoy lower priced products. As noted in CNT's petition, lower priced reconstituted milk products could especially benefit low income consumers, including the elderly and persons on fixed incomes. Milk is one of the most widely consumed products in our economy. A cost increase of even a few cents per gallon of milk aggregates to millions of dollars. Moreover,



there is a significant societal benefit in providing a lower priced nutritional product to the milk consuming public.

#### IV. CONCLUSION

The Justice Department, in its 1977 report on the effects of government regulation of the dairy industry, concluded:

Prohibitions upon the reconstitution of milk must of necessity result in a net social cost because there is no conceivable benefit to be derived from keeping a non-hazardous product off of the market\*

By eliminating barriers to reconstitution, the report added, There would be an adequate supply of fluid (fresh and reconstituted) milk to satisfy consumer demand, and prices would be more stable .... [T]he order system would continue to function, [and] farmers' income would be more stable .... These effects would be observed to different degrees depending upon the extent of consumer acceptance of reconstituted products\*\*

The proposed deregulation of reconstituted milk has the potential for achieving a substantial increase in the economic efficiency of the dairy farming sector of American agriculture. The Antitrust Division believes it would be in the public interest to hold hearings on the CNI petition and urges that this be done.

Respectfully submitted,

/s/ Donald L. Flexner

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DONALD L. FLEXNER  
Deputy Assistant Attorney General  
Antitrust Division

/s/ G. A. Connell

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GERALD A. CONNELL  
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Antitrust Division

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\**Milk Marketing*. A report of the U.S. Department of Justice to the Task Group on Antitrust Immunities, January 1977, at 428.

\*\**Id.* at 506-07.

/s/ Michael P. Harmonis

MICHAEL P. HARMONIS

Attorney

Antitrust Division

U.S. Department of Justice

Washington, D.C. 20530

JANUARY 15, 1980

BEFORE THE  
U.S. DEPARTMENT OF AGRICULTURE

---

HANDLING OF MILK IN FEDERAL  
MILK MARKETING AREAS

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COMMENTS OF THE  
COUNCIL ON WAGE AND PRICE STABILITY<sup>1</sup>

The Community Nutrition Institute (CNI), one fluid processor, and three individual consumers have requested a public hearing to consider changes in the regulatory treatment of reconstituted milk products under federal milk orders. The Council on Wage and Price Stability (Council) hereby submits its comments on the U.S. Department of Agriculture's prenotice of the request for hearing (44 *Fed. Reg.* 65989). Attached as Appendix A are the Council's responses to specific questions raised in the prenotice. Attached as Appendix C are the Council's comments on the scope of the proposed hearing.

The Council strongly supports a public hearing to consider amendments to federal milk orders that would eliminate the restrictive pricing provisions for reconstituted milk products.<sup>2</sup> Current milk marketing order provisions artificially increase the prices of reconstituted milk products above the prices of fresh fluid milk. Milk processors ("handlers") in those markets thus have no economic incentive to produce reconstituted milk. Consumers are deprived of an

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<sup>1</sup> The Council on Wage and Price Stability was created by the Council on Wage and Price Stability Act (P.L. 93-387) within the Executive Office of the President. The authority of the Council to intervene in governmental rulemaking and ratemaking proceedings, conferred by Section 3(a) of the Act, has been delegated to the Director of the Council (see 40 *Fed. Reg.* 52882).

<sup>2</sup> Within the definition of "reconstituted milk products" the CNI proposal includes filled-reconstituted milk, whey-soy drinks, and all other milk substitutes manufactured by combining powdered milk products with other liquids. For convenience these comments adopt CNI's definition, although reconstituted products can be manufactured using other technologies.

opportunity to benefit from a technology that would provide, in some markets, a lower-cost alternative to fresh fluid milk. The CNI proposal therefore has significant anti-inflationary potential and would particularly benefit low-income consumers.

### **I. THE CURRENT MARKETING ORDERS DISCRIMINATE AGAINST RECONSTITUTED MILK PRODUCTS.**

The dairy industry is a major part of the American economy. Federal milk marketing orders, authorized by the Agricultural Marketing Agreement Act, regulate the handling and farm-level pricing of about 65 percent of all milk produced in the United States.<sup>3</sup> The present federal milk orders and a number of similar state-enforced pricing programs regulate the treatment of most milk produced in the United States.

There are 47 federal marketing areas, each of which has its own marketing order. Each marketing order establishes minimum prices paid by milk handlers for fluid-eligible milk<sup>4</sup> according to its use—a higher price for milk used in fluid products (Class I) than for milk used in manufactured products (Class II or Class III). The revenues from these sales are pooled for each order so that the individual producer is paid on the basis of a uniform weighted-average price ("blend price"), regardless of how his raw milk is used.

The powder purchased for reconstitution is subject to "other source milk" provisions in the marketing orders. Such treatment requires paying local producers, through the order pool, an "equalization" payment amounting to the difference between the Class I price and the lower manufacturing-class price for raw milk used to make powder.

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<sup>3</sup> Boyd M. Buxton, Milk Marketing Order Regulations, *American Journal of Agricultural Economics*, Vol. 1, No. 4 (Part 2) November, 1979.

<sup>4</sup> Fluid-eligible milk is "Grade A" milk, which meets the highest sanitary standards and can be sold as fluid milk or used for manufacturing products such as butter, cheese, and milk powder. Grade B milk is not regulated under the order system and can only be used for manufacturing purposes.

This equalization is accomplished by the "down allocation" and "compensatory payment" scheme, as described in the Department's prenotice (44 *Fed. Reg.* 65990). The processors of reconstituted milk effectively pay the costs of the raw producer milk at manufacturing-class prices, plus the costs of drying, plus any transportation costs, plus the costs of reconstitution, plus a tax to local producers equal to the Class I differential. The result is that reconstituted milk products would have to be sold at a higher price than fresh milk.

Since the Agricultural Marketing Agreement Act was passed in 1937, the markets for both raw milk supplies and milk products have expanded significantly, due in part to developments in distribution techniques.<sup>5</sup> The federal order system, however, has tended to "freeze in" the local production and distribution system of the 1930's. The overall effect has been to deny the benefits of some of today's technology to producers, handlers, and consumers.<sup>6</sup>

Commercial reconstitution of milk has been technically feasible for a number of years.<sup>7</sup> This technology would make feasible the introduction of lower-cost alternative fluid milk products in many parts of the United States. However, by virtue of the regulatory "tax," which removes any economic incentive to reconstitute milk,<sup>8</sup> these products have effectively been removed from the market. As discussed in Part IV below, this is a result never intended by Congress in the Agriculture Marketing Agreement Act (see 7 U.S.C. 608c(5)(G)).

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<sup>5</sup> Alden C. Manchester, *Pricing Milk and Dairy Products: Principles, Practices and Problems*, USDA, Agricultural Economic Report No. 107 (June 1971), p.3.

<sup>6</sup> Paul W. MacAvoy, *Federal Marketing Orders and Price Supports*, American Enterprise Institute (1977), p.5.

<sup>7</sup> Jerome W. Hammond, Boyd M. Buxton and Cameron S. Thraen, *Potential Impacts of Reconstituted Milk on Regional Prices, Utilization and Production*, Station Bulletin 529, Agricultural Experiment Station, University of Minnesota, in cooperation with the Economics, Statistics, and Cooperative Service, USDA, p.3.

<sup>8</sup> There are also state restrictions on the production and sale of reconstituted products. *Ibid.*, pp. 18-19.

## II. THE EFFECTS OF THE PROPOSED AMENDMENTS.

The CNI proposal would amend federal marketing orders to: (1) remove reconstituted milk products from the definition of "other source milk" for purposes of eliminating the "down allocation" of milk ingredients used in such products; and (2) eliminate the requirement that processors of reconstituted milk products make "compensatory payments" for reconstituted products assigned to Class I. Under the CNI proposal, the reconstituted portion of fluid milk products would not be subject to the pricing provisions of the orders. The cost of producing reconstituted milk products would consist only of the costs of ingredients, any transportation costs, and the costs of reconstituting the milk.

Calculations by USDA staff show that the cost to handlers of totally-reconstituted milk products (without the down-allocation or compensatory-payment provisions) would be less than the cost of fresh milk at Class I prices in 27 of the 47 Federal orders.<sup>9</sup> These potential cost savings, if passed on to consumers, would range from less than a penny to 11 cents per gallon for a totally-reconstituted fluid milk product. In short, consumers are currently deprived of the opportunity to purchase a lower-priced alternative to fresh milk.

Attached as Appendix B is a recent study by Hammond, Buxton, and Thraen.<sup>10</sup> This study analyzes the changes that would take place if the regulatory treatment of reconstituted milk products were modified along the lines proposed by the petitioners and appropriate adjustments were made in fresh milk prices. Using a nine-region model, this study examines the effects of using reconstituted milk

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<sup>9</sup> Memorandum on Reconstituted Milk Analysis, from Joel L. Blum, Chief, Program Analysis Branch, Dairy Division, to Dairy Division Staff and all Market Administrators, November 16, 1979. These calculations excluded transport and recombination costs; but these costs are small and their inclusion would not change the result appreciably.

<sup>10</sup> Jerome W. Hammond, Boyd M. Buxton and Cameron S. Thraen, *Potential Impacts of Reconstituted Milk on Regional Prices, Utilization and Production*, Station Bulletin 529, Agricultural Experiment Station, University of Minnesota, in cooperation with the Economics, Statistics, and Cooperative Service, USDA, 1979.



products for blending with locally-produced fresh milk.<sup>11</sup> The study's primary conclusions are as follows:

- Reconstituted milk products would not account for a large percentage of consumption of fluid milk products in any market.
- The introduction of a new lower-cost alternative product would result in a decline in average prices of fluid milk products in all regions except two, the Lake States, and the Southwest. Average price declines for fluid milk products would be greatest in the Northeast, the Southeast, and the South Central regions. Retail price changes would range from an increase of 2 cents per gallon in the Southwest to a decline of 14 cents per gallon in the Southeast.
- If price support purchases are small or nonexistent, the average U.S. manufacturing price would increase moderately. If price support purchases are large, the manufacturing price is not likely to increase at all.
- The blend price and producer cash receipts would decline in four regions (the Northeast, Southeast, South Central, and Mountain States) and would rise in five regions (the Corn Belt, the Lake States, the Plains, the Southwest and the Northwest). Nationally, producer cash receipts would decline.
- While total raw milk production would decline slightly (by 0.2 percent), consumption of fluid milk products would increase (by 1.2 percent).
- Raw milk production would decline in four regions (the largest impacts being a 0.9 percent decline in the Northeast and a 1.6 percent decline in the Southeast) and rise in five more efficient producing regions.

<sup>11</sup> See especially pp. 12-18. This study assumes that the blended product would be a perfect substitute for fresh whole milk and that state regulations would not impede its introduction. Modifying these assumptions would not alter the general qualitative results of the analysis, although the magnitude of the adjustments on prices and quantities would be affected. The analysis uses 1976 data, but the direction of change would be similar if estimated for other years.

—More efficient use of economic resources would increase social welfare by from \$22 to \$25 million annually. That is to say, the current regulations imply a waste of economic resources equal to that amount.

While the Hammond study provides an indication of the types of changes that are likely to take place after the various markets have fully adjusted, the magnitude of these changes will depend on the validity of the underlying assumptions. For instance, the study assumes that blended reconstituted products would be perfect substitutes for fresh whole milk; and if, as is likely, consumers will prefer fresh milk, the impact of blended products on Class I differentials would be less than predicted by Hammond.

In sum, the benefits to the consumer of eliminating the present restrictions on reconstituted milk appear to be substantial, including considerably more efficient use of our nation's economic resources. The CNI proposal warrants a public hearing.

### III. THE PROPOSAL WOULD FURTHER THE GOALS OF THE ACT.

The basic objectives of the Agricultural Marketing Agreement Act are to: 1) establish and maintain orderly marketing conditions; 2) establish price to producers that will assure an adequate supply of milk, and 3) protect the interests of consumers and the public (7 U.S.C. 602). In the Council's view, lifting the restrictions on reconstituted milk is consistent with the goals of the market-order program.

As noted in Part II above, even if reconstituted milk products could be marketed without down allocations or compensatory payments, the introductions of these products is not likely to disrupt the market. It is unlikely that consumers would consider reconstituted products as a perfect substitute for fresh milk; indeed, such products would have to be labeled and marketed separately. Even if reconstituted products were a perfect substitute, as assumed by the Hammond study, consumption of reconstituted products would rise to only 2.2 percent of total fluid sales in the Southeast, the largest of any region. Hammond's study indicates that local fresh milk supplies within about 500 miles



of any market would be used rather than importing ingredients. In addition, state and local restrictions on reconstituted products will impede their introduction into a number of marketing areas.

Although removing the restrictions on the marketing of reconstituted milk products will lead to price and quantity adjustments, this transition will not cause disorder in the milk marketing system. Indeed, these changes would likely contribute to orderly marketing and increase market stability because: 1) dried milk can be easily stored and inexpensively shipped; and 2) reconstituted milk products could be used to provide an alternative supply of fluid milk products when fresh milk supplies are tight, thereby helping to coordinate seasonal variations in supplies and demands. Although milk production in some marketing areas would decline over time, production in the efficient dairy regions would increase and overall economic efficiency and stability would be enhanced.

In addition, federal-order pricing without restrictions on reconstituted products would still generate prices sufficient to assure adequate supplies of fluid milk. In fact, the total use of fluid milk products would increase. While the revenues received by producers in some regions would decline, revenues to producers in other regions would increase. And the existence of reserves in the form of powder would protect against supply shortfalls.

Further, the interest of consumers would be well served by removing the restrictions on reconstituted milk products. A lower-cost alternative to fresh milk would be available, in some areas Class I prices would be reduced, and the overall public welfare would be improved due to more efficient utilization of economic resources.

#### **IV. THE PRESENT RESTRICTIONS ON THE MARKETING OF RECONSTITUTED MILK PRODUCTS ARE ILLEGAL TRADE BARRIERS.**

As discussed in Part I above, application of the down-allocation and compensatory-payment provisions to the reconstitution of powder into fluid milk products has virtually eliminated such products from the market. These provi-

sions are inconsistent with Section 8c(5)G of the Agricultural Marketing Agreement Act, which states:

"No marketing agreement or order applicable to milk and its products in any marketing area shall prohibit or in any manner limit, in the case of the products of milk, the marketing in that area of any milk or product thereof produced in any production area in the United States."

This prohibition against trade barriers was analyzed by the Supreme Court in *Lehigh Valley Corp. v. United States* (1962) 370 U.S. 76. The milk marketing order in *Lehigh Valley* contained a compensatory payment provision that effectively required handlers who purchased milk from outside the marketing area to pay into the local producer pool an amount equal to the difference between the local Class I price and the manufacturing class price. As amici curiae, the dairy industry asserted that Section 8c(5)G only authorized outright prohibition of the importation of milk from other production areas. The Court held, however, that the word "prohibit" as used in the Act is not limited to absolute or quota physical restrictions; it also includes economic trade barriers such as a compensatory payment scheme that makes it uneconomical to market milk from outside the order area (370 U.S. at 97).<sup>12</sup>

The present order treatment of reconstituted milk closely parallels the compensatory payment scheme struck down in *Lehigh Valley*. As in that case, the present order provisions do not take into account the real costs of purchasing powder or reconstituting the milk product (370 U.S. at 84). As in that case, "the effect of the fixed compensatory payment is to make it economically unfeasible for a handler to bring such milk products into the marketing area" (*id.*). As the Supreme Court stated in that case:

"A close examination of the workings of the present compensatory payment provision reveals that its effect is to preserve for the benefit of the area's producers

<sup>12</sup> *Mills v. Freeman* (D. Md. 1961) 294 F. Supp. 119, seemed to adopt a meaning for "prohibit" that is somewhat inconsistent with the Supreme Court's treatment. But the Supreme Court's treatment is binding.

the blend price that they would receive if all outside milk were physically excluded and they alone would supply the fluid-milk needs of the area" (370 U.S. at 89).

In sum, the Secretary of Agriculture can establish incidental order provisions to protect the classification scheme (7 U.S.C. 608c(7)(D)). There is serious question, however, whether the present trade restrictions on the marketing of reconstituted milk products are valid. A public hearing on the treatment of reconstituted milk products is thus not only desirable as a matter of economic policy but also will further the provisions of the Agricultural Marketing Agreement Act.

Respectfully submitted,

/s/ D. A. Henderson  
 DAVID A. HENDERSON  
 Deputy General Counsel  
 /s/ R. R. Russell  
 R. ROBERT RUSSELL  
 Director

/s/ Thomas M. Lenard  
 THOMAS M. LENARD  
 Deputy Assistant Director for  
 Government Programs

FEBRUARY 29, 1980

## APPENDIX A

**The Council's Responses to Questions in Prenotice  
of Request for Hearing (44 *Fed. Reg.* 65989-65991)**

A. First set of questions beginning at 44 *Fed. Reg.* 65990:

Q 1. Is the proposal consistent with the requirement in the Agricultural Marketing Agreement Act that milk in similar uses be priced uniformly to handlers and, if not, what order changes would be consistent with such requirement and still carry out the intent of the proposal?

A. Although Section 8c(5)(A) of the Act requires raw milk to be classified according to the purposes for which it is used, the "use" is that of the handler who first purchases from the producer. The CNI proposal would not change this statutory requirement. The down-allocation and compensatory-payment provisions, on the other hand, are authorized under Section 8c(7)(D) of the Act as incidental provisions that may effectuate other aspects of the marketing orders. These incidental provisions are not statutorily required.

Q 2. Does the pricing of reconstituted products made entirely from powder and the pricing of blended products that contain a mixture of reconstituted milk and fresh milk present separate and distinguishable issues? If so, is there a need to consider different regulatory techniques for wholly reconstituted products versus blended products?

A. A 100% reconstituted milk product is a separate and distinct product from a blended milk product. In the Council's view, however, the reconstituted portion of blended products should be treated the same as totally reconstituted products.

Q 3. What are current State legal requirements on the processing, distribution, and labeling of wholly reconstituted products and blended products and do these requirements raise any important factors that need to be considered in conjunction with the proposal?

A. The regulatory treatment of reconstituted milk by states is described in the study by Hammond,

Buxton and Thraen, Appendix B, pp. 18-20. However, these regulations would not as a matter of law and should not as a matter of policy affect the treatment of reconstituted products under federal milk orders.

Q 4. Would the adoption of this proposal result in a need for substantive or conforming changes in the various order definitions, e.g., route disposition, distributing plant, supply plant, pool plant, other source milk, and fluid milk product?

A. The proposal specifically requests a change in the definition of "other source milk" as it is applied to reconstituted milk. It is not readily apparent what other changes would be needed, if any, and such changes should not be considered in this proceeding. (See the Council's comments on scope, Appendix C.)

Q 5. Would the adoption of the proposal require substantive or conforming changes in the classification provisions, e.g., classes of utilization, classification of transfers and diversions, general classification rules, and classification of producer milk?

A. Under the proposal, the reconstituted portion of fluid milk products would not be subject to the classified pricing provisions of the orders. If any of the classifications, diversions, or transfers are inconsistent with these proposed changes, those definitions would need to be changed.

Q 6. Would the adoption of the proposal require changes in either the order obligations or scope of regulation with respect to partially regulated distributing plants and producer-handlers?

A. The proposal only requests changes in the treatment of reconstituted milk, and such changes would not seem to require modifications of regulations concerning partially regulated plants and producer-handlers. If minor changes in some provisions may later prove necessary in particular market orders, they could be modified in subsequent proceedings (see Council's comments on scope, Appendix C).

Q 7. Does the adoption of the proposal also raise the issue of the appropriateness of the current Class I differentials and location adjustments under the orders? If so, what should such Class I differentials and location adjustments be?

A. The introduction of a new alternative product competing with fresh milk would, in some regions and over time, place downward pressures on fresh milk prices. However, the magnitude of the changes which may be necessary cannot be known unless and until reconstituted milk products are actually introduced into the market and the markets are given an opportunity to adjust. Therefore, while the level of Class I differentials is relevant to a hearing on changes in the regulatory treatment of reconstituted milk, specific proposals to change Class I differentials should only be considered on an order-by-order basis at a later time. Attached as Appendix C are the Council's views on the scope of the proposed hearing.

Q 8. Would the adoption of the proposed pricing for reconstituted milk require a change in the classification and pricing of condensed skim milk or condensed whole milk if the condensed product is used to reconstitute milk for fluid uses?

A. The CNI petition does not address the treatment of condensed milk products.

B. Second set of questions beginning at 44 *Fed. Reg.* 65991:

Q 1. What effect would the adoption of the proposal have on the achievement of the goals of the Agricultural Marketing Agreement Act?

A. Adoption of the proposal would be consistent with the goals of the Act, as discussed in the Council's Comments (pp. 8-10).

Q 2. Would the adoption of the proposal result in major adjustment costs for dairy farming and in processing facilities? Would this impact be different in different regions? How might the adjustment costs be minimized?

A. Estimates of the different regional impacts obtained by Hammond, Buxton, and Thraen (pp. 13-17) are discussed in the Council's Comments (pp. 5-8). The economic changes would not be in the same direction in all regions and, in addition, would depend on consumer acceptance of these alternative products. Given the magnitude of the estimated changes, we would not anticipate major adjustment costs for dairy farming or processing. Moreover, we believe that any such



changes would take place over a period of time, thereby allowing for an orderly transition for producers and handlers.

Q 3. What implications would the adoption of the proposal have on energy use in the processing, distribution, and transportation of all dairy products?

A. The Council believes that removing the restrictions on the marketing of reconstituted milk products will result in overall economic and energy efficiency (see Council's Comments at p. 8). Although additional costs will be incurred in the drying and reconstituting processes, these costs will be offset by savings in storage and transportation.

Q 4. How would the adoption of the proposal affect the aggregate consumption of dairy products? Would adoption of the proposal substantially alter the utilization of milk in different products and among different income groups? What are the nutritional implications of adopting the proposal?

A. Adoption of the proposal would result in an increase in aggregate consumption of fluid milk products. The impact of the proposal on consumption of manufactured products and total consumption of dairy products depends on the effect of the price support program. If price support purchases are small or nonexistent, consumption of manufactured products and total consumption of dairy products will decline moderately. If price support purchases are large, consumption of dairy products should rise.

Low-income consumers may well be more sensitive to dairy price changes, and therefore would benefit more from the introduction of lower-priced alternative products. All consumers would benefit, however.

Q 5. What regional implications does adoption of the proposal have for dairy farmers? What implications for producers of Grade A milk versus Grade B milk?

A. Estimates of the regional impacts on producers of Grade A milk are discussed in Hammond, Buxton, and Thraen (pp. 13-77) and the Council's Comments (pp. 6-8). Returns and prices for Grade B milk would probably not change if price support purchases are large, and would likely increase if price support purchases are small or nonexistent. There will also be shifts in production to more efficient production re-



gions, and overall economic efficiency will be increased.

Q 6. What economic implications, including those of a regional nature, does the adoption of the proposal have for consumers? What implications for fluid milk consumers versus consumers of manufactured dairy products?

A. Consumers in the aggregate would save. The discussion in Hammond, Buxton and Thraen (pp. 13-17) and the Council's Comments (pp. 5-8) show that prices for fluid milk products would decline in all regions except two. Retail price changes would range from an increase of 2 cents per gallon in the Southwest to a decline of 14 cents per gallon in the Southeast. The implications for prices and consumption of manufactured products are similar in all regions and are discussed in the answers to questions 4 and 5 above.

Q 7. Would the adoption of the proposal affect the dairy industry's ability to balance seasonal patterns of milk production and consumption? Would the needed reserve requirements for fluid markets be changed?

A. The adoption of the proposal would increase the industry's ability to balance seasonal patterns of consumption and production and reduce the needed reserves for fluid markets. (See Hammond, Buxton, and Thraen, p. 18 and Council's Comments, pp. 9-10.)

COMMUNITY NUTRITION INSTITUTE, ET AL., PLAINTIFFS,

JOHN R. BLOCK, SECRETARY OF THE UNITED STATES  
DEPARTMENT OF AGRICULTURE, ET AL., DEFENDANTS.

**NATIONAL MILK PRODUCERS FEDERATION,  
ASSOCIATED MILK PRODUCERS, INC., AND  
CENTRAL MILK PRODUCERS COOPERATIVE,  
INTERVENOR-DEFENDANTS.**

City of Washington )  
 ) ss  
District of Columbia )

1. I am the Director, Dairy Division, Agricultural Marketing Service, United States Department of Agriculture. The statements in this affidavit are based upon my personal knowledge or upon official records of the United States Department of Agriculture.

2. I was graduated from the University of Massachusetts and did post graduate work in economics at Harvard University. In 1935 I joined the staff of the Dairy Section of the United States Department of Agriculture and continued in that capacity, except for a brief time during World War II, until I was appointed Director, Dairy Division, Agricultural Marketing Service, in May 1954. Since joining the Dairy Section in 1935, I have been in intimate contact with the development and administration of federal milk marketing orders and since 1945 have had increasing responsibility for their formulation and the supervision of their administration in all marketing areas under regulation.

3. I make this affidavit in support of the government's motion to dismiss or in the alternative for summary judgment.

4. The marketing order provisions which include reconstituted fluid milk in the Class I pricing provisions of the federal milk marketing orders, challenged by plaintiffs in this proceeding, were adopted by the Secretary in 1963 and 1964. With regard to 15 New England and Northeast markets, formal rulemaking hearings were conducted: on September 13-14, 1962 and March 5-April 2, 1963, in Philadelphia, Pennsylvania, to take evidence with respect to federal milk marketing orders Nos. 1004 and 1010 (7 CFR 1004 and 1010, except that these orders have been merged into a single order for the Middle Atlantic Region, No. 1004, since 1963); on September 5-21, 1962 and April 1-19, 1963, in New York City and Woodbridge, New Jersey, respectively, to take evidence on orders Nos. 1002 and 1015 (7 CFR 1002 and 1015, except that these orders have been merged since 1963); and on May 6-23, 1963, in New York City, to take evidence with respect to orders Nos. 1001-1004, 1006, 1007, 1010, and 1014-1016 (7 CFR 1001 etc., except that some orders have been merged or terminated since 1963). Based on the hearing records thus developed, the Secretary issued initial decisions recommending adoption of various order provisions (see 28 FR 3419, 6139, 6171, 7598 and 10646). Thereafter, in November 1963 final decisions adopting various provisions were published (28 FR 11848, 11956 and 12000). With regard to other marketing areas, formal rulemaking hearings were conducted on January 2-4 and 23-25, 1963, in Arlington, Virginia, to take evidence with respect to federal milk marketing orders Nos. 1003, 1005, 1008, 1009, 1011, 1013, 1016, 1033-1037, 1040-1044, 1046-1049, 1090, 1098, 1101 (7 CFR 1003, etc., except that some orders have been merged with other orders or terminated since 1963). On January 8-11, 1963, a second hearing was held in St. Louis, Missouri, for the purpose of taking evidence with respect to federal milk marketing orders Nos. 1030-1032, 1038, 1039, 1045, 1051, 1061-1064, 1067-1070, 1078, 1079, 1094, 1096, 1097, 1099, 1102, 1103, 1105, 1107, and 1108 (7 CFR 1030, etc., except that some

orders have been merged with other orders or terminated since 1963). A third hearing was held on January 14-18, 1963, in Denver, Colorado, where evidence was presented with respect to federal milk marketing orders Nos. 1065, 1066, 1071-1076, 1104, 1106, 1120, 1125-1138 (7 CFR 1065, etc., except that some orders have been merged with other orders or terminated since 1963). Based on the evidence introduced at these hearings and the records thereof, the Secretary issued initial decisions recommending adoption of the order provisions regulating reconstituted milk (29 FR 2001, 29 FR 2101, and 29 FR 2202, respectively). Comments received in response to these recommended decisions were considered by the Secretary and then in July 1964, he published final decisions adopting the marketing order provisions under consideration (29 FR 9002, 29 FR 9110 and 29 FR 9214, respectively). Following the publication of all of these decisions, the amended order provisions were subjected to producer referendums in each of the affected marketing areas and were favorably approved by the requisite number of producers.

5. The contested order provisions were thereafter extended, in 1969, to apply to reconstituted fluid milk used in the processing of filled milk. Following publication in the Federal Register of the Notice of Hearing listing various issues for consideration, the Secretary convened a national hearing on April 23-24, and May 21-24, 1968, in Memphis, Tennessee, for the purpose of taking evidence with regard to the appropriate regulatory treatment of reconstituted milk used to make filled milk. With regard to the central Arizona order, the record from a hearing previously convened on February 7-10, 1967, was reopened as part of the national hearing. On June 17, 1969, recommended decisions were issued covering proposed changes in all then existing milk orders (34 FR 11802 and 11809). Following receipt and analysis of comments received in response to the recommended decisions, the Secretary issued final decisions approving and adopting the provisions for all milk marketing orders (34 FR 16548 and 34 FR 16881). The amendments were thereafter voted on in producer referendums and approved by the requisite number of producers.

6. Under the present marketing order system milk is classified on the basis of the use to which it is put by each handler. Class I is the highest value use and Class II and Class III (in a three class market) represent the lower value uses. Each order presently defines reconstituted milk that is used for fluid consumption as a "fluid milk product" and includes it in Class I, the same as fluid milk products made from raw producer milk. This assures that all milk used for fluid consumption is priced at least at the minimum Class I price level. Each of the 47 orders operates so that milk from producers is followed to its ultimate use by a plant and priced according to that use. If a handler obtains his entire supply of milk from producers and has only Class I sales, all of the milk is priced in Class I even if the handler first dries producer milk and then uses it in reconstituted fluid milk. However, a handler may use powder processed from producer milk received in a prior month or powder from other federal order markets or from unregulated sources, which in these instances was made from milk priced only at the lower manufacturing value. To prevent such reconstituted milk from being priced differently from other milk in fluid uses, and thus, resulting in nonuniform prices to handlers, the orders are designed so that the reconstituted milk made from such "other source milk" is priced on an equal basis with the price charged the handler making reconstituted milk from current receipts of producer milk. This is accomplished by assigning reconstituted milk made from such powder to the lower-valued uses of a handler. This process is commonly referred to as "down-allocation." If the handler does not have sufficient Class II (or Class III) utilization in his plant to cover the quantity of reconstituted milk, the remainder is assigned to Class I. In that event, the handler is required to make a "compensatory payment" with respect to the quantity assigned to Class I. The payment is equal to the difference between the order's Class I and Class II prices (in a two-class market) and is distributed to producers supplying milk in the marketing area.

7. The Agricultural Marketing Agreement Act provides in Sections 608c(3) and (4) as follows:

(3) Notice and hearing.

Whenever the Secretary of Agriculture has reason to believe that the issuance of an order will tend to effectuate the declared policy of this chapter with respect to any commodity or product thereof specified in subsection (2) of this section, he shall give due notice of and an opportunity for a hearing upon a proposed order. (7 U.S.C. 608c(3)).

(4) Finding and issuance of order.

After such notice and opportunity for hearing, the Secretary of Agriculture shall issue an order if he finds, and sets forth in such order, upon the evidence introduced at such hearing (in addition to such other findings as may be specifically required by this section) that the issuance of such order and all of the terms and conditions thereof will tend to effectuate the declared policy of this chapter with respect to such commodity. (7 U.S.C. 608c(4)).

Section 608c(17) provides that the procedure applicable to the issuance of such marketing orders shall also be applicable to amendments to such marketing orders.

Accordingly, a critical element that must be determined by the Secretary prior to noticing a proposal for hearing is whether the issuance of that proposal as part of a marketing order "will tend to effectuate the declared policy" of the Act. The Secretary is also required, when issuing an order, to make a finding that the issuance of such marketing order or amendment thereto is the only practical means of advancing the interests of the producers of such commodity pursuant to the declared policy of the Act and is approved or favored by at least two-thirds of the producers voting in a referendum. (7 U.S.C. 608c(9)(B)).

8. The essence of the CNI proposal is to amend the marketing orders so as to reclassify commercially processed reconstituted milk in the lowest price class of each order and thereby remove such milk from the Class I pricing provisions of the orders. These proposed amendments raise very complex issues which cut through to the very heart of the milk marketing order system and, if adopted, will substantially impact on the dairy industry of this nation. Furthermore, while there are, at the present time, serious



unresolved questions as to whether the proposed amendments will in fact tend to effectuate the declared policy of the AMAA, it is clear that noticing the proposal for hearing will commence a process requiring substantial expenditures of time and money by the proponents of change, the opponents of change and the federal government. For these reasons, following the receipt of plaintiffs' petition for rulemaking on or about August 28, 1979, the Department initiated a comprehensive investigation, which is still in progress, to determine whether a notice of hearing should be issued. The investigation has resulted in the Department's receipt of over 9,000 public comments and has involved preparation of a detailed economic impact statement analyzing the potential effects of the proposed amendments. The Department's activities in this regard are listed chronologically (some of the dates are approximated) in the lettered paragraphs which follow.

a. 8/31/79—Acknowledged receipt of the CNI petition.

b. 9/10/79—Completed for Departmental use a brief issues paper on the reconstituted milk proposal. The paper raised three general concerns regarding the proposal, i.e., legality, variable regional impact and cost to society.

c. 9/14/79—Completed Part I of the briefing paper on the proposal for Departmental use. The paper summarized the proposal and the current regulatory treatment of reconstituted milk.

d. 9/28/79—Sent a letter to CNI indicating that clarification of the proposal would be needed before the petition could be considered further.

e. 10/5/79—Sent a letter to CNI asking questions to help clarify the proposal.

f. 10/5/79—Completed Part II of a briefing paper on the proposal for Departmental use. The paper made assumptions on how the proposal should be interpreted and set forth some general observations on the probable impact on handlers, consumers, and producers. The paper also set forth policy issues relative to the proposal and alternative actions and their impact.

g. 10/17/79—A meeting of representatives from various Departmental agencies was held concerning procedures



that would be involved if a hearing were held on the CNI proposal.

h. 10/23/79—Completed for Departmental use some observations regarding the University of Minnesota Study on reconstituted milk that was done by Jerome Hammond, Boyd Buxton and Cameron Thraen. This study was referred to in the CNI petition.

i. 10/25/79—A meeting of representatives of the Department and CNI was held to discuss the reconstituted milk proposal and the questions asked in the Department's 10/5/79 letter to CNI.

j. 10/26/79—Sent a letter to CNI concerning the 10/25/79 meeting about the proposal. Letter stated that the Department planned to move ahead with a pre-notice of hearing to inform the public of the petition and that a public hearing was being considered.

k. 11/1/79—Received a letter from CNI responding to questions presented in the Department's 10/5/79 letter.

l. 11/8/79—Sent a letter to all market administrators requesting their attendance at a meeting on 12/6/79 with members of the Washington Dairy Division staff to discuss the reconstituted milk proposal. Written comments on the proposal were requested from each by 11/30/79.

m. 11/9/79—Completed for Departmental use a paper titled, Comments on Study by Jerome W. Hammond, Boyd M. Buxton and Cameron S. Thraen entitled *Potential Impacts of Reconstituted Milk on Regional Prices, Utilization, and Production*, Station Bulletin 529, Agricultural Experiment Station, University of Minnesota, 1979. This study was referred to in the CNI petition.

n. 11/13/79—Completed for Departmental use comparisons of the cost of fresh skim milk to the cost of Grade A powder.

o. 11/16/79—Issued a pre-notice of request for hearing on the CNI proposal and invitation to submit additional proposals. The pre-notice summarized the proposal and the current regulatory treatment of reconstituted milk. Comments were requested on the proposal as well as eight issues that were identified as possibly being related to the proposal. The pre-notice also asked seven specific questions

that were developed in connection with the Department's efforts to analyze the potential impact of the proposed changes, as well as comments on whether a hearing should be held. Comments and alternative proposals were to be filed by 1/15/80. (Exhibit B to the Complaint).

The pre-notice was published in the Federal Register (44 FR 65989) and mailed to all market administrators for further distribution pursuant to the interested party list for each Federal order market. The pre-notice was also mailed to 50 governors and a list of consumer-oriented groups or individuals, some of whom were identified for mailing by CNI.

p. 11/20/79—A meeting of representatives from several Departmental agencies was held to discuss the development of a pre-hearing impact statement concerning the CNI proposal and alternative options. The statement was to be developed as an aid in determining whether a hearing should be held.

q. 12/6/79—Meeting was held with all market administrators concerning the CNI proposal.

r. 12/10/79-10/24/80—Received, reviewed, categorized and filed comments submitted by interested parties in response to the pre-notice of request for hearing. Comments received after the 2/29/80 deadline were included since the Department had not yet decided whether a hearing should be held (work was continuing on the development of the preliminary impact statement). In total, 8,949 letters were received from interested parties, most being received from dairy farmers (8,113). (Some dairy farmers wrote more than one letter).

s. 12/18/79—Completed for Departmental use a set of questions and answers on the pricing of reconstituted milk under federal orders.

t. 12/28/79—Completed for Departmental use a report on the impact of reconstituted milk on the cost of nutrition to consumers and on the cost of the dairy price support program.

u. 1/4/80—A meeting of representatives from several Departmental agencies was held to discuss a draft of the impact analysis regarding the CNI proposal.

v. 1/15/80—Issued a public notice extending the time for filing comments and alternative proposals as solicited by the pre-notice of request for hearing. The time was extended to February 29, 1980. Extension of time had been requested by representatives of the dairy industry on the basis that they did not have sufficient time to analyze the impact of the proposal and prepare their comments. The notification procedure utilized was the same as that utilized for the pre-notice except that an additional 190 interested parties associated with a proposed federal order for the Boise area were included. (Exhibit C to the Complaint).

w. 1/21/80—A meeting of several Department officials was held to discuss the adequacy of public participation in the deliberations on the reconstituted milk issue. It was decided to prepare a fact sheet about the proceeding for dissemination to the public.

Another meeting of Department officials was held to discuss legal questions relating to the CNI proposal.

x. 1/30/80—Wrote 69 Congressmen, who had expressed an interest in the CNI proposal, about the status of the reconstituted milk deliberations and enclosed a background paper on the issue.

y. A meeting of representatives from several Departmental agencies was held to discuss another draft of the impact statement on reconstituted milk.

z. 2/5/80-10/21/80—During this period, an additional 174 letters were sent to Senators and Congressmen who had expressed interest in the reconstituted milk issue.

aa. 2/14/80—Completed an update on the reconstituted milk issue that was mailed to a list of known consumer organizations and others. The development of the paper was initiated at the 1/21/80 meeting and various drafts were reviewed by Department officials prior to mailing.

bb. 2/14/80—Completed a review of material used to develop the table (Table 6) on State regulations that apply to reconstituted fluid milk products. Table 6 is contained in Station Bulletin 529, *Potential Impacts of Reconstituted Milk on Regional Prices, Utilization and Production*, authored by Hammond, Buxton and Thraen.

cc. 2/29/80—Department personnel completed a review of another draft of the impact statement.

dd. 3/4/80—A meeting of major Department officials was held to review the status and partial findings of the impact analysis on reconstituted milk and to discuss legal questions.

ee. 3/11/80—Completed and forwarded answers to questions for the record by Mr. McHugh, House of Representatives Agricultural Subcommittee. Five of seven questions pertained to the reconstituted milk issue.

ff. 4/14/80—Completed for Departmental use a summary of views filed by interested parties in response to the pre-notice of hearing. At the time the summary was made, about 7,600 letters had been received from the public. Letters received after this date were reviewed, categorized, and filed but were not summarized as the views expressed were already well represented.

gg. 5/6/80—A meeting of major Department officials and officials from other Governmental units was held to discuss the reconstituted milk issue and the tentative findings of the impact analysis. It was decided that further analytical work on the issue should be undertaken before deciding whether a hearing should be held on the CNI proposal.

hh. 5/7/80-11/6/80—Several additional drafts of the impact statement on reconstituted milk were developed, and reviewed by Department officials.

ii. 11/7/80—Issued a request for public comments on a preliminary impact statement on proposed amendments to all federal orders. The impact statement was published in the Federal Register (45 FR 75956). The statement analyzed the potential impact of the CNI proposal and several other alternatives. The public was invited to submit comments on the impact statement as well as to submit alternative proposals or modifications to the CNI proposal that would mitigate any adverse economic impacts of the CNI proposal. Comments were to be filed by 1/2/81. (Attachment E to the Complaint).

The impact statement was mailed to all market administrators for subsequent distribution in accordance with the interested parties list for each federal order market. The

impact statement was also mailed to 50 governors, approximately 600 individuals associated with the proposed Alabama and Boise area federal orders, approximately 260 interested parties on an updated consumer organization list, and about 100 interested parties associated with State and local governments that responded to the pre-notice of hearing.

jj. 11/14/80—Sent letters informing 189 concerned Senators and Congressmen of the issuance of the preliminary impact statement.

kk. 12/2/80—Began receiving, reviewing, categorizing and filing views submitted by the public in response to the preliminary impact statement. As of 2/16/81, approximately 484 comments had been received from the public.

ll. 12/22/80—Completed and issued a notice extending the time for the filing of comments on the impact statement to 2/16/81. The same notification procedure that was used for the impact statement was utilized. (Attachment A).

9. a. The Department's preliminary impact statement sets forth the potential economic impact on consumers, dairy farmers, and the federal government that is considered likely to result from the plaintiffs' proposal to change the regulatory treatment of reconstituted milk under all federal milk marketing orders. The impact analysis is based on marketing data for the year 1978.

b. Under plaintiffs' proposal, the cost of reconstituted milk would be the price for milk in manufacturing uses—Class III (or Class II in a two-class market)—plus the cost of drying fresh milk and reconstituting the milk powder back into fluid milk. Assuming that reconstituted milk blended with fresh fluid milk is made available to consumers at a lower price than fresh fluid milk, the study projects that within three years such product would account for up to 38 percent of the fluid milk consumption in the United States. Most sales of reconstituted milk would displace sales of locally produced fresh fluid milk, which local milk would then be directed into manufacturing uses with a corresponding reduction in the price received by farmers. In addition, it is likely that some locally produced milk would be diverted into powder manufacturing solely to permit it



to be reclassified in a lower priced class under an order and thereafter sold locally as reconstituted fluid milk.

c. On a national basis, the study indicates that the shift to reconstituted milk could result in a yearly reduction in cash farm receipts for dairy farmers of up to \$520 million. However, the total projected social benefits of the proposed change in pricing would amount to only \$351 million (a decrease of \$186 million in consumer expenditures for fluid milk and a decrease of \$165 million in government expenditures for dairy product purchases under the dairy price support programs, all as a result of the reduction in price), and thus, would not completely offset the reduction of farm receipts.

d. The projected economic impacts for each of nine regions in the United States identified in the study vary widely with the greatest impacts being felt in the Northeast and Southern areas of the country. Projected cash farm receipts from milk would decline by nearly 14 percent in the Southeast region and by 6 percent in the South Central region. In the Northeast region, the decline for dairy farmers would be 7 percent, or \$247 million annually. This reduction in farm income would be accompanied by a moderate decline in nationwide milk production of approximately .64 percent, with the greatest reductions being felt, again, in the Northeast (1.46 percent decline) and the Southeast (1.77 percent decline) regions. The unequal impact on dairy farm income would also, in all probability, result in some geographic realignment of milk production in the United States.

e. Other impacts which could also be expected to flow from the adoption of the proposed amendments are: (1) A reduction in the non-fat solids content of milk (reconstituted and blended milk) from the naturally occurring level of approximately 8.6 percent to the legal required minimum of 8.25 percent, which would be the result of fluid milk processors desiring to minimize the cost of producing reconstituted milk for fluid consumption; (2) an increase in the cost of administering milk orders, due to the resultant increase in reporting and verification activities that would be required to monitor compliance; and (3) a



possible increase in dairy support prices to offset the reduced farm income and to stabilize geographic areas of milk production (farmers would be expected to press hard for such an increase) with a resultant increase in prices to consumers for most manufactured dairy products (i.e., products other than those in Class I).

f. The effects on the dairy industry reflected in the preliminary impact statement are highly significant and require that the Secretary give the proposed amendments the most critical examination practical in light of the objectives of the AMAA, before initiating the costly and time consuming process of rulemaking with regard to the proposed amendments.

10. a. Since the close of the comment period of February 16, 1981, the Department has been reviewing the comments received in response to the impact statement. When this process is completed and taking into consideration all of the data generated since the proposal was submitted by plaintiffs (through public participation and the Department's own analysis), a decision will be made as to whether or not the proposed amendments, if adopted, will tend to effectuate the declared policy of the AMAA.

b. If it is determined that the proposed amendments will not tend to effectuate the policy of the AMAA, the proposal will be denied and the plaintiffs will be notified of the reasons therefor, as provided in section 900.3 of the rules of practice (7 CFR 900.3), and that will end the proceeding; however, under this circumstance the plaintiffs, as well as any other interested parties, are free to rethink their position and to submit a different or a modified version of their proposal for the Department's consideration.

c. Alternatively, if it is determined that the proposed amendments would tend to effectuate the policy of the AMAA, the Department will issue a hearing notice on the proposal and any other proposals that may have been received during the investigation period, which are determined to be consistent with the policy of the AMAA. The procedures set forth in 7 CFR 900.4-900.18 will then control the progress of the formal rulemaking process which is required for the issuance of or amendment to federal milk

marketing orders. Thus, hearings would be held and plaintiffs would be required to present evidence, under oath and subject to cross examination by any hearing participant, in support of the proposed amendments. In addition, other participants, including any additional proponents and any opponents of the changes, would similarly present their evidence. Based on the hearing record thus produced (i.e., the hearing testimony and any exhibits as well as any proposed findings and briefs submitted by interested parties) the Department would first prepare and issue a recommended decision, which would be published and otherwise made available for public comment. Thereafter, at the close of the comment period the Department would issue a final decision. If the final determination is to reject the proposed amendments the proceeding would be terminated at that point. However, if any amendments are adopted, they would not become effective until after being approved by producers in referendums held in each of the 47 marketing order areas.

11. Finally, with regard to the availability of milk powder for reconstitution by consumers, milk powder, made from milk accounted for by handlers at Class II (or Class III) prices under the orders, is presently, and has been for the last 30 years, readily available at retail levels. Interested consumers may purchase such powder and reconstitute it by adding water. In addition, by blending this reconstituted milk with fresh milk in equal portions it can be made indistinguishable from the fresh milk. Finally, the cost to the consumer of this home reconstituted milk is likely to be less than the cost of commercially reconstituted milk in all cases because the consumer avoids having to pay the handlers' costs associated with reconstituting, packaging, and marketing the fluid product.

/s/ Herbert L. Forest

**HERBERT L. FOREST**

**Director, Dairy Division**

**Agricultural Marketing Service**

**United States Department of Agriculture**

Subscribed and sworn to before me  
this 18th day of March 1981.

/s/ Sue E. Toms

SUE E. TOMS  
Notary Public

My commission expires on January 31, 1982.

UNITED STATES DEPARTMENT OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE  
WASHINGTON, D.C. 20250

April 7, 1981

Ms. Ellen Haas and Mr. Thomas B. Smith  
Community Nutrition Institute  
1146 19th Street, N.W.  
Washington, D.C. 20036

Dear Ms. Haas and Mr. Smith:

This is in further response to the petition on reconstituted milk that you submitted to the Department on behalf of the Community Nutrition Institute, a fluid milk distributor, and three consumers. Petitioners ask that all Federal Milk orders be amended to "eliminate the restrictive pricing provisions" pertaining to reconstituted fluid milk products.

After an extensive analysis of the petition, we have concluded that a public hearing should not be held to consider amending the orders in the manner sought by petitioners. Basically, the analysis indicates that the proposed order changes would lead to substantial financial losses to dairy farmers while providing negligible benefits to consumers. It is our belief that the proposal, if adopted, would not tend to effectuate the declared purposes of the Agricultural Marketing Agreement Act of 1937, as amended, which is the statutory authority for milk orders.

We have reached this conclusion after a careful and thorough review of the issues presented by the proposal. It became evident, after our early review of the petition, that the impacts of the proposed order changes were potentially far-reaching and significant. The Department, therefore, took steps to assure itself that the many ramifications of the proposal had been fully considered. The Department's review of the petition included two major efforts. First, the public was invited to submit comments on the reconstituted milk proposal and on whether the proposal was an appropriate subject for a public hearing. Second, a comprehensive preliminary economic impact statement was developed

and submitted to the public for comment. In both cases, we received numerous responses from a broad cross-section of the dairy industry, state governments, and consumer groups.

From our analysis of the proposal and the some 9,000 public comments on the proposal and the preliminary impact statement, we find that there are a number of significant reasons why the reconstituted milk proposal would be inconsistent with the intent of the Act. We particularly note the following bases for our finding:

1. *Adoption of the reconstituted milk proposal would make meaningless the classified pricing of milk and thus thwart the intent of the Congress.*

The Agricultural Marketing Agreement Act of 1937, the legislation for milk orders, provides for the classification of milk according to its use and for the setting of minimum prices for each class. Prices are to be uniform among all handlers in the regulated market. 7 U.S.C. 608c(5)(A)

The proposal by CNI and others would eliminate the "down-allocation" of nonfat dry milk used in reconstituted milk and the "compensatory payment" on any reconstituted milk assigned to Class I uses. The thrust of the proposal is to reclassify commercially processed reconstituted milk in the lowest price class of each order. When processed for drinking purposes, reconstituted milk is now classified as Class I milk along with other milk products processed for fluid consumption.

The projected effect of the proposal would be that in many of the Federal order markets—primarily those in the South and East where Class I prices are the highest—reconstituted milk would be priced to handlers at a lower price than other milk in fluid uses. In these markets, there would be a strong economic incentive for handlers to substitute reconstituted milk for other fluid milk (or "fresh" milk) to the extent consumers would accept the product. A blend of reconstituted milk and fresh milk could be expected to make major inroads on the current sales of fresh milk in the southern and eastern markets.

In markets where some fluid products are being made from fresh milk and others from lower-priced reconstituted

milk, there would not be uniform prices among handlers for milk being sold for fluid consumption. Handlers using fresh milk would not be able to compete on an equitable basis with handlers using reconstituted milk. To stay competitive, they would be forced to reduce their purchases of fresh milk and instead turn to the processing of reconstituted milk. Producers losing their fluid milk outlets then would have to channel their supplies to lower-valued manufacturing uses.

It was for these reasons that the current classification and pricing of reconstituted milk were adopted. Such regulations were established and later reaffirmed on the basis of extensive deliberations by the dairy industry, academicians, and the Government in formal rulemaking proceedings. The provisions were widely supported as a reasonable means of providing uniform classification and pricing among handlers.

When Congress enacted legislation authorizing milk orders, it specifically authorized classified pricing because earlier experience had demonstrated that such pricing could ameliorate the disorder and unstable conditions that exist in fluid milk markets in the absence of classified pricing. If milk orders were to classify and price reconstituted fluid milk products other than as Class I, the result would be a disregard for the basic purposes underlying classified pricing. Under this circumstance, the regulatory objectives intended by Congress would not be carried out.

*2. The competitive problems that would result from the reconstituted milk proposal would lead to pressures to lower Class I prices for fresh milk, which would precipitate major changes in the dairy industry.*

The petition of CNI and others does not propose the lowering of Class I prices. However, if reconstituted milk were reclassified in a lower class, handlers in the southern and eastern markets who prefer to use fresh milk would be forced from economic pressures to shift to reconstituted milk to remain competitive. These handlers could do this by purchasing powder or, as would be more likely, separating and drying milk and then reconstituting it. This waste of energy and non-uniformity in pricing would generate con-



siderable pressures for lower Class I prices for fresh milk so that fluid milk products could continue to be made from fresh milk and be competitive with reconstituted milk. If the Class I prices were not lowered at the outset, it is reasonable to assume that this eventually would have to occur.

The Department's preliminary impact statement sets forth the extent to which "prevailing" Class I prices would have to be lowered to meet the competition from reconstituted milk if the CNI proposal were adopted. The estimated price declines were \$1.48 per hundredweight (13 cents per gallon) in the Southeast, and \$1.12 per hundredweight (10 cents per gallon) in the South Central region. While the analysis was based on 1978 data, we believe the impact statement nevertheless is useful in portraying the general impacts that might be expected.

A substantial decline in Class I prices would result in a major drop in returns to producers. Nationally, annual cash receipts from milk marketings could drop an estimated \$576 million (based on 1978 marketing data). Farm prices could drop about 41 cents per hundredweight. Dairy farmers in the East and South would be adversely affected the most. Farm prices could drop about 71 cents per hundredweight in the Northeast, about 75 cents in the South Central region, and about \$1.47 in the Southeast.

The greatest total income loss to dairy farmers would be in the Northeast, and would amount to about \$264 million a year. The application of an income multiplier would substantially increase the economic loss to rural communities in that area.

We believe that adopting provisions in milk orders that can result in changes of this magnitude goes far beyond the intent of Congress when it authorized milk orders. The orders were established as a means of helping dairy farmers, not putting them out of business. The reconstituted milk proposal, which is supposed to benefit consumers, could set in motion economic forces that could severely alter an industry that has provided the public with an adequate supply of high-quality milk at reasonable prices, as Congress intended. There is no indication that the limited benefits

that would accrue to consumers could justify such a radical change in the dairy industry.

We recognize that milk orders may tend to foster certain production and marketing patterns that might not otherwise exist in an unregulated setting. It might well be, for example, that there would have been less milk production in the southern and eastern markets over the years in the absence of regulation. However, there has been no indication that our society has found this development to be an undesirable result of marketing orders. The order program is a marketing arrangement that Congress continues to sanction, and one that it obviously considers to be operating in the public interest. If milk orders are to be used to effectuate changes in the national marketing structure in the magnitude noted above, it would appear that the proper avenue for determining if such changes are desirable would be the legislative process, not the administrative route.

*3. Adoption of the reconstituted milk proposal would result in negligible benefits to consumers.*

Nationally, per capita savings to consumers from lower prices for reconstituted milk would be relatively limited (about 82 cents per capita annually). Moreover, consumers could experience higher prices for various manufactured dairy products, including milk powder sold in stores for reconstituting in the home. This could stem from a stronger demand for milk powder for commercial reconstitution as well as possible price support increases for manufacturing milk that might be considered necessary to offset some of the expected decline in dairy farmer income.

Total savings for consumers and the Federal Government would be considerably less than the projected loss in income for dairy farmers. Based on 1978 data, it was estimated that after operating for 3 years under the proposal, the order changes, on an annual basis, would (1) reduce consumer expenditures by \$186 million, (2) reduce Government Commodity Credit Corporation purchases by \$165 million, and (3) reduce cash receipts to dairy farmers by \$520 million.

4. *Consumers already have a lower-cost alternative to fresh milk.*

Consumers may buy nonfat dry milk at grocery stores and reconstitute skim milk by adding water to the powder at home. Also, they can easily blend this reconstituted product with fresh whole milk if they prefer a product with some butterfat in it. Milk reconstituted at home would continue to be cheaper than commercially reconstituted milk under the CNI proposal because of the added costs of labor, packaging, refrigeration, and distribution.

5. *The public would not be assured of having a commercially reconstituted milk product that is as nutritious as fresh milk.*

With the economic advantage that reconstituted milk would have over fresh milk under the CNI proposal, handlers would be expected to reduce the nonfat solids content of fluid milk products to the legally permitted minimum level. In most states, the product standards require a minimum of 8.25 percent nonfat solids in milk, which is considerably lower than the approximate 8.75 percent nonfat solids level found in packaged whole milk. Thus, in making a reconstituted product, handlers presumably would add no more powder to water than would be necessary to meet the minimum nonfat solids level. In making fluid milk products from fresh milk, handlers could dilute the solids level of the milk by blending in reconstituted milk containing less than the minimum solids. The nutrient value of milk could then decline and consumers probably would pay more than they do now for the same nutrition from fluid milk products.

With respect to another facet of the petition, we note that petitioners raise several legal considerations that cannot be resolved in a rulemaking proceeding. In the petition, it is contended that the "current market order provisions exceed the scope of the Secretary's authority under the Agricultural Marketing Agreement Act." In this regard, petitioners make the following claims:

(1) The restrictive pricing provisions are unnecessary to protect milk producers.

(2) These provision are contrary to the policy of the Act to protect against unreasonable fluctuations in supplies and prices.

(3) The provisions create a barrier to the marketing of nonfat dry milk in violation of the Act.

(4) The Secretary has no authority to regulate the price of milk substitutes made from powdered milk or whey.

Claims that the present regulatory treatment of reconstituted milk is not in accordance with law must be resolved through procedures other than public hearings. These claims are at issue in the lawsuit initiated by the petitioners in the United States District Court for the District of Columbia (*Community Nutrition Institute v. Block*, No. 80-377 (D.D.C.)). Accordingly, in reviewing the petition for rulemaking purposes, we have not directed our attention to these claims of the petitioners.

For the reasons set forth above, the proposal submitted by the Community Nutrition Institute and others is denied.

Sincerely,

/s/ William T. Manley

WILLIAM T. MANLEY  
Deputy Administrator  
Marketing Program Operations

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-3077

COMMUNITY NUTRITION INSTITUTE, ET AL., PLAINTIFFS,

v.

JOHN R. BLOCK, ET AL., DEFENDANTS.

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AFFIDAVIT OF THOMAS B. SMITH

City of Washington )

) ss:

District of Columbia)

Thomas B. Smith, being duly sworn, deposes and says:

1. The statements in this affidavit are either based upon my personal knowledge or upon figures obtained from records of the United States Department of Agriculture and its publications. I am making this statement in support of the plaintiffs' cross-motion for summary judgment and in opposition to defendants' motions to dismiss or, in the alternative, for summary judgment.

2. I am an economist employed by the Community Nutrition Institute ("CNI") in Washington, D.C. I have worked for CNI since 1977. Since that time, I have worked on numerous projects involving the regulation of milk and have developed a thorough understanding of the Federal milk marketing order system.

3. I received a Bachelor of Arts degree, Magna Cum Laude, in economics from Dickinson College, Carlisle, Pennsylvania in 1976.

4. CNI is a nonprofit charitable organization specializing in food and nutrition issues and is primarily concerned with the development, adoption and implementation of a national food policy which serves the health and economic needs of consumers, particularly low income consumers. CNI has designed and participated in "Buying Skills Programs" and "Nutrition Education Programs" dedicated to educating low income consumers of the various alternative sources of

low-cost nutritional food. CNI also works with various state and local anti-hunger and nutrition assistance programs in educating the programs' low income recipients on the various alternative sources of low-cost nutritional food. CNI, as an association, has a substantial interest in providing the greatest possible amount of information concerning low cost sources of nutritional food.

5. In February of 1980, I called the Office of the Hearing Clerk at the Department of Agriculture to make arrangements to review the records compiled by the Secretary during hearings on reconstituted milk and other issues. I spoke with Cheryl Scoville and asked to review the following hearing records: AO-219-A21, AO-293-A7, AO-271-A7, AO-271-A12, AO-213-A21, AO-361-A3, AO-366-A8, and AO-219-A12. Ms. Scoville informed me that some of the records were available in the hearing clerk's office, but that others would have to be obtained from the Department's record file in Suitland, Maryland. She asked if it was necessary to produce the entire record of each hearing and asked if I could limit my request to specific hearings or parts of each hearing transcript. I responded that I did not know which parts of the transcript covered the issues I was interested in and therefore I would need to see the full transcript of each hearing. She agreed to order the records I had requested, but said it would take several days or longer.

6. After the records arrived, I spent several partial days at the hearing clerk's office in the Department of Agriculture reviewing different parts of these records and took notes on those records in which reconstituted or filled milk regulation was discussed. In sum, I spent approximately 16 hours reviewing these records.

7. From my search through these transcripts I found that the hearing format permitted any hearing attendee to question witnesses. Consequently large parts of the hearing transcripts were repetitive and extraneous to the CNI petition on reconstituted milk.

8. I would characterize those parts of the record I reviewed as consisting primarily of conclusory statements by dairy industry representatives, including cooperatives,



handler trade associations, and academicians. In the records I reviewed I did not find any independent economic or market impact evaluation by the Department of Agriculture supporting the need for the regulations on reconstituted and filled milk. With the exception of a study submitted by the Milk Industry Foundation, I found virtually no economic evaluation of any kind.

9. Down allocation provisions and the imposition of a compensatory payment equal to the difference between the Class I and Class II rates on reconstituted milk makes it uneconomic for handlers to produce and market reconstituted milk products. In those order areas I have studied, the addition of the compensatory payment drives the price of reconstituted milk to the handler higher than the price the handler must pay for fresh skim milk.

10. A number of factors determine the cost of producing a reconstituted milk product. First, there is the cost of the milk powder, the primary ingredient. The market price of powder is generally determined by the current support price the Federal government will pay for powder. Since the Federal government is an ever-available customer for powder at the support price, as a practical matter, powder will usually not be sold for less than the support price on the open market. A second factor is the cost of transporting the powder from the area where it is produced to the area where the reconstituted milk product is manufactured. The third component is the cost associated with warehousing the milk powder and processing it into a reconstituted milk product. The final component is the compensatory payment imposed by the Milk Market Orders. This payment is the difference between the Class I and Class II (or Class III) prices within the order area.

11. Using the March, 1981, Federal support price for milk powder of approximately 94 cents per pound, I computed the approximate cost of producing reconstituted milk product in various order areas in the United States. To compute the total costs to the manufacturer, I multiplied \$.94 by 8.5, which is the approximate number of pounds of milk powder in 100 pounds of reconstituted milk. I then added 5 cents for warehousing, handling and processing. I

also included a charge for transportation based on the cost of shipping milk powder from Chicago, Illinois to the order area. (The transportation, warehousing and processing costs were taken from a 1979 study *Potential Impacts of Reconstituted Milk on Regional Prices, Utilization, and Production* by Hammond, Buxton and Thraen published by the Agricultural Experiment Station, University of Minnesota, in cooperation with the Economics, Statistics and Cooperatives Service of the U.S. Department of Agriculture). Finally, I added the compensatory payment.

12. I computed the price of manufacturing reconstituted milk product in the following example marketing order areas: St. Louis/Ozarks, New England, Ohio Valley, and Chicago Regional. In each instance, the compensatory payment drove the cost of the reconstituted milk higher than the Class I price for fluid milk in the order area. In the St. Louis/Ozarks order area, the total cost of 100 pounds of reconstituted milk would be approximately \$9.73, compared to the announced cooperative Class I price equivalent for skim milk of \$9.10. (This price includes "over-order premiums" charged by dairy cooperatives and is reduced by the butterfat differential of 16.9 cents per .1 percent x 3.5 percent butterfat.) In New England, the final cost of reconstituted milk would be approximately \$11.14 per 100 pounds, compared to the announced cooperative Class I skim milk price of \$9.89. For the Ohio Valley order area, the cost of manufacturing 100 pounds of reconstituted milk would be \$9.83, compared to \$9.12 for Class I skim milk. In the Chicago Regional order area, the cost of reconstituted milk would be \$9.27, compared to \$8.73 for Class I skim milk.

13. In each of these cases, without the compensatory payment the cost of the reconstituted milk product would have been lower than the announced cooperative Class I price for fresh fluid skim milk. The compensatory payment for each of the areas was: St. Louis/Ozarks—\$1.57; New England—\$2.94; Ohio Valley—\$1.67; and Chicago—\$1.23. (In Chicago, the reconstituted milk product would be more expensive than fresh skim milk if milk cooperatives there reduced the size of their "over-order premiums" by 50 percent or more.)

In accordance with 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct. Executed on May 1, 1981.

/s/ Thomas B. Smith

THOMAS B. SMITH

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-3077

COMMUNITY NUTRITION INSTITUTE, ET AL., PLAINTIFFS,

v.

JOHN R. BLOCK, SECRETARY OF THE  
UNITED STATES DEPARTMENT OF AGRICULTURE,  
ET AL., DEFENDANTS,

and

NATIONAL MILK PRODUCERS FEDERATION,  
ASSOCIATED MILK PRODUCERS, INC., AND  
CENTRAL MILK PRODUCERS COOPERATIVE,  
INTERVENOR-DEFENDANTS.

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AFFIDAVIT OF JAMES R. BOX

Cook County

State of Illinois

JAMES R. BOX, being duly sworn, deposes and says:

1. I have been employed as Director of Marketing, Associated Milk Producers, Inc. (AMPI), Mid-States Region, Chicago, Illinois since July, 1977. This affidavit is made in support of the motion of intervenor-defendants National Milk Producers Federation, Associated Milk Producers, Inc. and Central Milk Producers Cooperative to dismiss or, in the alternative, for summary judgment and in opposition to the plaintiffs' cross-motion for summary judgment.

2. I received a Bachelor of Science degree in economics from Auburn University, Auburn, Alabama in 1967 and a Master of Science degree in economics from Auburn in 1968.

3. Following completion of my academic training, I was employed as a marketing specialist trainee by the office of the Milk Market Administrator, Order No. 30, Chicago Regional Marketing Area where I remained for approximately one year. Following a year of training in the Order 30 Mar-

ket Administrator's office, I transferred to the Dairy Division, Agricultural Marketing Service, United States Department of Agriculture, Washington, D.C. where I was employed as an economist in the Dairy Division's Order Formulation Branch.

4. My duties in the Order Formulation Branch of the Dairy Division included review of Federal milk order promulgation and order amendment hearing records, analysis of the hearing record evidence, preparation of findings and conclusions relating to proposed amendments, and participation in the formulation of new or amended milk orders.

5. After working for three years in the Order Formulation Branch of the Dairy Division, I returned in 1972 to the Order 30 Market Administrator's Office in Chicago, Illinois where I was employed as a dairy economist. My employment required that I become completely familiar with: (1) the compilation and analysis of the Order 30 Market Order statistics which are routinely published by the Agricultural Marketing Service, Dairy Division; (2) the operative provisions of the Federal milk orders; (3) the system of butterfat and skim accounting that is used in computing milk handlers' pool obligations under Federal milk orders; and (4) the several systems and techniques used by Market Administrators to audit or verify the "use value" of the milk or milk products received by regulated milk handlers.

6. I terminated my employment with the Order 30 Market Administrator's Office in July, 1977, when I accepted the position of Director of Marketing for AMPI Mid-States Region. The Mid-States Region encompasses Indiana, Illinois, Wisconsin, and a portion of Michigan. Within that Region AMPI markets milk to handlers regulated by Chicago Regional Order No. 30, Indiana Order No. 49, Central Illinois Order No. 50, Southern Illinois Order No. 32, Michigan Upper Peninsula Order No. 44, St. Louis-Ozarks Order No. 62, Louisville-Lexington-Evansville Order No. 46, Ohio Valley Order No. 33 and Iowa Order No. 79.

7. During the course of my employment, both in the Order 30 Market Administrator's office and with AMPI, I have become familiar with the terms upon which handlers purchase milk from cooperatives or independent producers

in AMPI's Mid-States Region and in other areas of the country. In the midwest and northeastern part of the United States there is no Federal order area where only a single cooperative supplies all of the milk received by regulated handlers. For that reason there is no single ascertainable Class price for milk in any such Federal order area except the monthly Class prices announced by the Federal milk market administrator in the area.

8. In those areas of the midwest where handlers are supplied by a dominant cooperative, the cooperative's published price announcement does not specify or announce a "cooperative Class I price . . . for skim milk" nor may such a price be determined from the cooperative's announced Class I price for whole milk.

9. Regulations governing the production and distribution of fluid milk require, almost without exception, that all such fluid milk products, including reconstituted milk, be produced from a Grade A milk supply. There are standards and regulations governing the production and handling of Grade A non-fat dry milk powder which include the requirement that such powder is produced only from Grade A raw milk.

10. The market price of Grade A milk powder cannot be ascertained from the current, minimum support price for milk powder as announced by the Commodity Credit Corporation. Milk powder purchased under the Federal support program is not required to be Grade A. The market price for Grade A powder is reported weekly by the United States Department of Agriculture, Federal-State Market News Service.

11. Approximately 8.7 pounds of non-fat dry milk powder may be extracted from the 96.5 pounds of skim milk contained in 100 pounds of 3.5 percent butterfat whole milk. To make 100 pounds of reconstituted milk requires 9 pounds of non-fat dry milk powder.

12. Attached hereto as Exhibit A and made a part hereof is a comparison of the minimum Federal order Class I skim value, for the indicated Federal milk orders with the ingredient cost of 100 pounds of reconstituted Grade A skim milk based upon published price data for March, 1981.



13. The information and statements in this affidavit are based upon my personal knowledge or upon data published by or under the direction of the United States Department of Agriculture.

14. I declare under penalty of perjury that the foregoing is true and correct.

/s/ James R. Box

JAMES R. BOX

Dated: MAY 27, 1981

# EXHIBIT A

## COMPARISON OF CLASS I SKIM VALUE PER CWT. AT MINIMUM FEDERAL ORDER PRICE WITH INGREDIENT COST OF 100 POUNDS RECONSTITUTED GRADE A SKIM MILK FOR FOUR ORDERS, MARCH 1981

Federal Orders	Order Class I Skim Value	Price Per Lb. Grade A NFDM <sup>1</sup>	Reconstit. NFDM Value Per Cwt. <sup>2</sup>	Amount Class I Order Skim Exceeds (+) Or Is Less (-) Per Cwt. Than Reconstituted NFDM		Dollars Per Gal. Diff. <sup>3</sup>
Chicago Regional	\$7.99	.96	\$8.64	-.65		-.056
St. Louis-Ozarks	\$8.33	.96	\$8.64	-.31		-.027
Ohio Valley	\$8.42	.99	\$8.91	-.49		-.042
New England	\$9.65	.99	\$8.91	+.74		+.064

<sup>1</sup> Source, *Dairy Market News*, Regional Report, U.S.D.A. Federal-State Market News Service, Grade A Non-Fat Dry Milk Power (NFDM).

<sup>2</sup> Assumes 9.00 pounds NFDM yields 100 pounds of skim milk. No labor or processing costs included.

<sup>3</sup> Amount Federal Order Class I skim value exceeds (+) or is less than (-) reconstituted NFDM Value divided by 11.6 (gallons skim per cwt.).

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-3077

COMMUNITY NUTRITION INSTITUTE, ET AL., PLAINTIFFS,

v.

JOHN R. BLOCK, ET AL., DEFENDANTS.

---

AFFIDAVIT OF JOSEPH J. OBERWEIS

City of Aurora )

) ss:

State of Illinois)

Joseph J. Oberweis, being duly sworn, deposes and says:

1. The statements in this affidavit are either based on my personal knowledge and experience or upon figures obtained from records of the United States Department of Agriculture and its publications. I am making this statement in support of the plaintiffs' cross-motion for summary judgment and in opposition to the Federal defendants' and intervenor-defendants' motions to dismiss, or in the alternative, for summary judgment.

2. I am Chairman of Oberweis Dairy, an Aurora, Illinois milk processing concern founded by my father and which is now approximately 55 years old. Oberweis Dairy is considered a regulated milk handler operating under Federal Milk Marketing Order Number 30.

3. I have been a milk handler for 51 years, during which time I have witnessed the birth and development of Federal Milk Marketing orders and the consolidation of market power by the dominant milk producer cooperatives operating in what is now Order Number 30.

4. For handlers operating under Federal Milk Marketing orders, including Order Number 30, "over order" premiums, or surcharges, constitute an important part of the total price routinely charged by dairy cooperatives selling grade A milk for Class I uses. It is unrealistic and misleading to characterize the Federal Class I price (as set by the

Marketing orders) as the cost of Class I milk for the handler, because substantial over order surcharges are regularly added to that price by producer cooperatives, thus effectively raising the cost to handlers.

5. In April, 1981 Central Milk Producers Cooperative, of which Associated Milk Producers, Inc., is a member, offered to sell Oberweis Dairy milk from receiving plants for \$1.22 per cwt. over Federal Order price, not including transportation. I was able to purchase substantial supplies for about \$1.15 per cwt. over the Order price.

6. The down-allocation and compensatory payments provisions of the Federal Milk Marketing orders protect the local cooperatives from competition from reconstituted milk products, thereby enhancing the ability of large dairy cooperatives to charge sizable over order surcharges. Absent the compensatory payment, I could manufacture reconstituted milk for less than the price I pay for Class I milk.

7. In accordance with 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct.

/s/ Joseph J. Oberweis

JOSEPH J. OBERWEIS

Dated: JUNE 3, 1981

Subscribed and sworn to before me  
this third day of June, 1981.

/s/ Marie Oberweis

MARIE OBERWEIS, Notary Public  
Kane County, Illinois

My commision expires 12/19/84.

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

Civil Action No. 80-3077

COMMUNITY NUTRITION INSTITUTE, ET AL., PLAINTIFFS,

v.

JOHN R. BLOCK, ET AL., DEFENDANTS.

---

SUPPLEMENTAL AFFIDAVIT OF THOMAS B. SMITH

City of Washington )

) ss:

District of Columbia)

Thomas B. Smith, being duly sworn, deposes and says:

1. The statements in this affidavit are either based on my personal knowledge and experience, figures obtained from records and publications of the U.S. Department of Agriculture, or formal submissions made to the Department by other Federal agencies and private firms in the industry. I am making this statement in support of Plaintiffs' Reply to Defendants' Opposition To Plaintiffs' Cross-Motion For Summary Judgment. The statement supplements my affidavit of May 1, 1981, submitted in the above-referenced action (hereinafter "First Smith Affidavit").

2. Warehousing, processing, and transportation costs included in the First Smith Affidavit were either drawn directly or computed from data presented in a 1979 USDA-supported study. (*Potential Impacts of Reconstituted Milk on Regional Prices, Utilization, and Production*, Jerome W. Hammond, Boyd M. Buxton, Cameron S. Thraen, 1979, pages 7-10). The study was conducted by three researchers, one a USDA employee, at the University of Minnesota Agricultural Experiment Station in cooperation with the USDA Economics, Statistics and Cooperatives Service.

3. The market price for Grade A milk powder is reported weekly by the USDA Federal-State Market News Service publication, *Dairy Market News*, and this publication provided substantiation for the \$.94 per pound figure (the Federal purchase price for milk powder) used as the cost of

powder in the computations in the First Smith Affidavit. In report Number 11, Volume 48, the Market News Service stated that, "Sales of NDM in the Chicago area are slow . . . offerings of Powder are ample." Prices quoted ranged from \$.9325 per pound and \$.9600 per pound. (Page 4). However, in the Eastern and Southern Markets, the Service reported that "more plants are offering lower prices, to the trade, for milk powder as they try to keep inventories low. Many reports indicate offerings as low as .9100 FOB were not uncommon". (Page 6).

4. The minimum quantity of milk solids not fat that would be permitted in 100 pounds of reconstituted milk product is 8.25 pounds. Since milk powder is 3 percent moisture and .8 percent butterfat (the remainder is milk solids not fat) approximately 8.5 pounds of milk powder would be required to supply the minimum amount of milk solids not fat to a reconstituted product. 9 pounds would be used if a greater concentration of milk solids not fat were desired.

5. The effective Class I skim milk prices, to which the cost of manufacturing reconstituted milk products were compared in the First Smith Affidavit, were computed from data contained in a table in the USDA Federal-State Dairy Market News Service publication *Dairy Market News* (Volume No. 48, Report No. 14, April 6-10, 1981, page 11) entitled "Minimum Federal Order and Announced Cooperative Class I Prices in Selected Cities." As set forth in the First Smith Affidavit "the announced cooperative Class I price *equivalent*" (emphasis added) was computed by adding the over-order premiums charged by cooperatives to the Federal order Class I prices (or simply using the announced cooperative Class I prices included in the table) and then subtracting an amount for the butterfat which is removed from the whole milk (assumed to be 3.5 percent butterfat) to make skim milk. (Whether cooperatives or handlers remove the fat is immaterial; the prices used for purposes of comparison clearly reflect the value of the skim milk purchased in the areas and used for Class I purposes.)

6. The Federal-State Market News Service publication indicates that over-order premiums are announced and reg-



ularly added to the Federally-established Class I prices. As a footnote explanation of its table of prices, the Service says that

"This table contains such information as can readily be obtained as to over-order Class I prices announced for the beginning of the month by cooperative associations in various markets . . . These data are common market knowledge in the sense that the information represents basic Class I price announcements by the cooperatives sent to all handlers who buy milk from them..." (Page 11).

While the Market News Service also notes that such over-order prices have not been verified as actually being paid by handlers and that they may change or be adjusted during the month, the price quotes are clearly representative of the type of over-order prices handlers in individual cities would pay for raw milk to be used as Class I.

7. Over-order charges should be considered in the computation of the cost of fresh milk used in Class I so that a realistic price comparison to the cost of reconstituted products can be made. USDA itself has included the price impact of over-order charges in computing the cost of Class I milk as compared to the reconstituted product. In an October 12, 1979 memorandum from the Acting Director of the Dairy Division, W.H. Blanchard, to the Administrator of the Agricultural Marketing Service, Barbara Schlei, Mr. Blanchard, using the Southeastern Florida Market as an example, compares the cost of fresh skim milk to nonfat reconstituted milk and adds to the fresh skim milk Federal order price the over-order premium then being charged by cooperatives. Mr. Blanchard states, "In September, Southeastern Florida handlers paid cooperatives an 'over-order' Class I price of \$15.60 for milk containing 3.5% butterfat. This was \$1.56 per hundredweight above the minimum order price. The over-order Class I price translates to 90.2 cents per gallon of skim milk." Mr. Blanchard calculated the price of the reconstituted product as 67.8 cents per gallon. (Mr. Blanchard also includes a 5% per hundredweight cost of "processing" the reconstituted products in his calculation.)

8. In its comments to USDA on the CNI petition on reconstituted milk, the Milk Industry Foundations (MIF), a prominent dairy industry trade association counting both milk cooperatives and milk handlers among its members, also included the "over-order charge" in computing a handler's Class I price for fresh milk as compared to the price of manufacturing reconstituted milk. According to the MIF, "Another important factor to consider when comparing the cost of reconstituted and fresh milk is the market's over-order charge. During October of 1979 the over-order charge announced by the major cooperatives in the Chicago area was 89¢" per 100 pounds of milk in Class I (page 8). MIF concluded that in October, 1979 in Chicago, the ingredients in fresh Class I milk would have cost 26% per hundred weight or 2% a gallon more than the ingredients in reconstituted milk if down allocation or compensatory payments were not required.

9. Over-order charges should be included in the computations for comparing the prices of fluid milk and reconstituted milk. Were it not for the compensatory payment, reconstituted products could be manufactured for less than the effective cost to the handler of purchasing raw skim milk for Class I uses in most, if not all, milk market orders in the U.S.

10. There are market order areas in which the compensatory payment drives the cost of manufacturing reconstituted milk higher than the Federal order Class I price established by USDA.

11. Using the same assumptions and procedures as outlined in the First Smith Affidavit (§§ 10-11) I computed the price of manufacturing a reconstituted milk product with no butterfat in the following additional Federal milk marketing order areas: Central Arkansas, Texas, and Tampa Bay. In each instance, the compensatory payment drove the cost of the reconstituted product higher than both the Federal order Class I price for fluid skim milk and the cooperative over-order price in the order area. (For the Tampa Bay order area, however, no information on over-order charges could be obtained.) In the Central Arkansas order area, the total cost of manufacturing 100 pounds of reconstituted

milk (including the compensatory payment) would be approximately \$10.11 compared to the Federal order Class I skim price of \$8.68 and the announced cooperative over-order price of \$9.36. In the Texas order area, the final cost of 100 pounds of reconstituted milk would be \$10.61, compared to the Federal order Class I skim price of \$9.05 and the announced cooperative over-order price of \$9.54. In the Tampa Bay order area, the total regulated cost of 100 pounds of reconstituted milk would be approximately \$11.13 as compared to the Federal order Class I skim price of \$9.68. In each of these cases, without the compensatory payment the cost of the reconstituted product would have been lower than both the Federal order Class I price for skim milk and the announced cooperative over-order price for fresh skim milk. The compensatory payment for each of the areas was: Central Arkansas—\$1.91; Texas \$2.29; and Tampa Bay—\$2.77.

12. In the preceding computation, for purposes of comparison to a nonfat reconstituted products, a fresh Class I skim price was computed by deducting the Federal order butterfat differential (16.9 cents per .1 percent x 3.5 percent butterfat) from the Federal order Class I price for whole milk in each market order area. Over-order prices were determined by deducting the same butterfat differential from the announced cooperative over-order prices for each order areas published in *Dairy Market News*. (Vol. No. 48, Report No. 14, April 6-10, page 11).

13. In some milk order areas, an elimination of the down allocation and compensatory payment requirements could limit the size of over-order charges significantly. In fact, in a "Briefing Paper on CNI's Reconstituted Milk Proposal" prepared by the AMS Dairy Division on December 18, 1979, it was stated that reconstituted milk "could put downward pressure on the present Federal order Class I prices and over-order prices in those markets where reconstituted products would have a price advantage over fresh milk". (Page 3).

14. According to the Department of Justice Antitrust Division, in a February 12, 1981 submission to USDA on the recently completed Impact Analysis on the CNI petition on

reconstituted milk, "current regulations ensure that any local or regional markets are substantially isolated from competition from other areas because fluid milk is expensive to transport over long distances . . . Consequently, local producers often can obtain a considerable premium from handlers over the Federal order minimum price for Class I milk. If local handlers could economically turn to reconstituted milk they would substantially undermine the potential market power of local producers and limit their ability to extract premium prices". (Page 6).

15. The current down allocation and compensatory payment provisions of the Federal Milk Orders clearly make it uneconomic for handlers to produce and market reconstituted milk. This is especially true in the areas of the country where milk production is most expensive.

16. USDA itself has recognized this fact by stating in the November 17, 1980 preliminary Impact Statement on the CNI reconstituted milk petition (Fed. Reg. Vol. 45, No. 223, 11/17/80, page 75965) that "with no change in the pricing of reconstituted milk, handlers in most areas would continue to have a strong disincentive to use reconstituted milk rather than fresh milk in processing fluid milk products."

17. In accordance with 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct. Executed on June 4, 1981.

/s/ Thomas B. Smith

THOMAS B. SMITH

**Supreme Court of the United States**

No. 83-458

JOHN R. BLOCK, SECRETARY OF AGRICULTURE, ET AL.,  
PETITIONERS,

v.

COMMUNITY NUTRITION INSTITUTE, ET AL.

ORDER ALLOWING CERTIORARI. Filed November  
28, 1983.

The petition herein for a writ of certiorari to the United  
States Court of Appeals for the District of Columbia Circuit  
is granted.